

# OVERSIGHT OF THE GRACE COMMISSION'S PROCUREMENT RECOMMENDATIONS

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## HEARING BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE NINETY-NINTH CONGRESS FIRST SESSION

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JANUARY 23, 1985

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## OVERSIGHT OF THE GRACE COMMISSION'S PROCUREMENT RECOMMENDATIONS

WEDNESDAY, JANUARY 23, 1985

U.S. SENATE,  
SUBCOMMITTEE ON OVERSIGHT  
OF GOVERNMENT MANAGEMENT,  
COMMITTEE ON GOVERNMENTAL AFFAIRS,  
*Washington, DC.*

The subcommittee met at 9:30 a.m., in room 342 of the Dirksen Senate Office Building, Hon. William S. Cohen (chairman of the subcommittee) presiding.

Present: Senators Cohen, Levin, and Chiles.

Staff present: Susan M. Collins, staff director; Jeffrey A. Minsky, staff investigator; Linda J. Gustitus, minority staff director; Ralph White, minority professional staff assistant; Bob Coakley, minority professional staff assistant; Frankie de Vergie, chief clerk; Rachel D. Harlan, assistant chief clerk; and Deirdre O'Callaghan, intern.

### OPENING STATEMENT OF SENATOR COHEN

Senator COHEN. The Subcommittee on Oversight of Government Management has convened a hearing to evaluate the Grace Commission's recommendations for procurement reform.

As most people know, the Grace Commission was established in June 1982 by Executive order to identify ways to reduce the cost of the Federal Government. Overall, the Commission came up with nearly 2,500 recommendations, resulting in projected cost savings of some \$424 billion over a 3-year period.

In procurement alone, the Commission estimated that \$34.5 billion could be saved over 3 years if the Government improved its procurement practices. Today's hearing is going to concentrate on those Grace Commission recommendations which account for most of the projected savings in procurement.

Every year, about half of the Government's discretionary budget is spent purchasing goods and services, ranging from paper clips to tanks. The Federal Government is projected to spend nearly \$600 billion on procurement over the next 3 years. Consequently, improvements in Federal contracting procedures often translate into significant savings. For example, the Competition in Contracting Act, signed into law last year, is estimated to save billions of dollars over the next few years, if it is effectively implemented.

The 98th Congress was particularly productive for procurement reform with the enactment of the competition law, the reauthorization of the Office of Federal Procurement Policy, passage of Sena-

tor Levin's spare parts amendments, and the enactment of the Small Business and Federal Procurement Competition Enhancement Act. We hope to build on those efforts during this Congress and the Grace Commission's work provides a very good starting point.

The purpose of this hearing is to evaluate the Commission's recommendations, to assess the potential savings, and determine which proposals should be implemented. Many of the Commission's recommendations apply Governmentwide, such as reducing the proliferation of procurement regulations; lessening the impact of social and economic requirements for small-dollar contracts; making greater use of multiyear contracting to enhance program stability; encouraging more contracting out; and simplifying the specifications by which the Government describes its needs.

One Governmentwide issue of particular interest to me concerns the Office of Federal Procurement Policy. The Grace Commission recommends that OFPP should play a strong, central leadership role in procurement policymaking. The administration, however, now proposes to merge OFPP into the management side of OMB, which many experts believe would diminish the Office's effectiveness.

We're going to explore whether this reorganization proposal is inconsistent with the Commission's finding that a strong, central procurement office is essential.

Other Commission recommendations pertain primarily to the Department of Defense. Since the Defense Department is responsible for nearly 80 percent of all Federal procurement, these recommendations tend to carry very big price tags.

Specifically, the subcommittee is going to examine the Grace Commission's recommendations for consolidating acquisition management within the Defense Department, improving cost-estimating techniques for major weapons systems, and strengthening the role and accountability of program managers.

The Commission's proposals for reorganizing the acquisition function within DOD have sparked considerable debate and controversy, and I hope that we can explore that today. The Department of Defense disputes the Commission's contention that many procurement problems spring from the current organizational structure. And, moreover, a recent study by the Center for Strategic and International Studies, to which Jack Gansler and Norm Augustine contributed, reaches a different conclusion on the organization of DOD acquisition.

Another source of controversy concerns the Commission's cost estimates. The General Accounting Office and the Congressional Budget Office, for example, maintain that the Grace Commission has overestimated many of its projected savings, and Defense Department officials point out that some savings are counted more than once. Yet, even scaled-down estimates result in significant savings. If only one-tenth of the Grace Commission's procurement savings were feasible, we could still save more than \$1 billion a year.

In my judgment, the healthy debate over cost savings takes nothing away from the ideas proposed. I believe that the Grace Commission has been extremely instrumental in focusing our attention

on ways to control the spiraling cost of Government. As our Nation faces a widening disparity between Federal revenues and expenditures, it's essential that we improve the management of Government programs. After all, a dollar saved through better management contributes to deficit reduction just as much as a dollar saved through budget cuts or raised by tax hikes. Even those Commission recommendations with small price tags can improve the way in which the Government does business and delivers services.

This morning, the Oversight Subcommittee is going to receive testimony from the Grace Commission representatives, administration officials, and other procurement experts, and we look forward to hearing their testimony.

I anticipate that several other members will be here this morning. At that time, I will yield to them for their statements.

We will proceed by welcoming our first witness this morning, Mr. J.P. Bolduc, chief operating officer of the Foundation for the President's Private Sector Survey on Cost Control.

Mr. Bolduc will explain the Grace Commission's major findings and recommendations for procurement reform. He is accompanied by William Tremayne, who is the senior vice president of Prudential Insurance Co. Mr. Tremayne headed the Grace Commission's Task Force on the Office of the Secretary of Defense.

Mr. Bolduc, your statement, I notice, is fairly lengthy. If you would care to summarize it, I'm sure that we would all appreciate that.

**TESTIMONY OF J.P. BOLDUC, CHIEF OPERATING OFFICER, FOUNDATION FOR THE PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL (GRACE COMMISSION), ACCOMPANIED BY WILLIAM H. TREMAYNE, SENIOR VICE PRESIDENT, THE PRUDENTIAL INSURANCE CO. OF AMERICA, AND JOHN GISH, GROUP VICE PRESIDENT, W. R. GRACE AND CO.**

Mr. BOLDUC. Thank you very much, Mr. Chairman.

What I'd like to try to do is run through the statement very briefly and highlight certain excerpts from it.

Mr. Chairman, I'm pleased to accept your invitation to discuss the work of the President's Private Sector Survey on Cost Control, known as the Grace Commission, or PPSS, for short, and to identify some of our major recommendations related to the Government's procurement of goods and services.

My name is J.P. Bolduc. I was the survey's chief operating officer. And I am currently president of Citizens Against Waste, a newly established bipartisan foundation organized to educate the public about waste and inefficiency in Government.

I am also senior vice president of W.R. Grace & Co.

With me on my left this morning is Mr. William Tremayne, who is a senior vice president with Prudential Insurance Co., and who also served as project manager for the Office of the Secretary of Defense, Task Force on PPSS.

Mr. John Gish, on my right, is a group vice president with W.R. Grace & Co. and also served with PPSS as director of special projects.



Prior to discussing our findings and recommendations on procurement, let me provide a very brief overview of PPSS's formation, organization, and conclusions.

On June 30, 1982, President Reagan issued an Executive order establishing PPSS. J. Peter Grace, chairman and chief executive officer of W.R. Grace & Co., was named to head the survey. More than 2,000 private sector volunteers worked on this 18-month study at no cost to the Federal Government, which I think is a point that needs to be emphasized, Mr. Chairman, and one that has not always been carried accurately in the media. In total, the private sector donated \$76 million in people, services, travel, supplies and other related expenses.

The survey's findings were detailed in 47 individual task force reports, which, including a two-volume Summary Report to the President, totaled about 21,000 pages of report material, with an additional 1.5 million pages of work paper backup.

We made 2,478 recommendations to eliminate waste and inefficiency and to enhance Government revenues. Assuming full implementation, those 2,478 recommendations would save the Government and the taxpayers \$424.4 billion over 3 years.

Turning to the subject of today's hearing, PPSS recommendations for procurement reform could save an estimated \$34.5 billion over 3 years. In addition, there are savings of \$37.1 billion over 3 years possible in the related areas of privatization and contracting out, and \$11.7 billion in 3-year savings possible from eliminating wage-setting laws which increase Federal procurement costs, but which are no longer necessary, nor productive. And there we refer to Davis-Bacon, Walsh-Healey, and Contract Services Act.

Total savings of \$83.3 billion over 3 years are possible by reforming the Government's method of acquiring goods and services.

Mr. Chairman, you requested that I focus my testimony on 10 specific procurement issues which the subcommittee believes to be most significant.

You will find in my prepared statement on page 4 that there's a table that outlines those 10 specific areas, and adjacent to each one, provides the 3-year estimated dollar savings.

Let me now very briefly summarize each one of those 10 areas of improvement opportunity.

First, as it relates to enhancing the role of the Office of Federal Procurement Policy.

In 1974, as you know, Congress created the Office of Federal Procurement Policy, known as OFPP, within the OMB. When OFPP was established, it was intended to have policymaking authority in the area of procurement. As it has evolved, however, OFPP has little authority to implement changes in Federal procurement.

Insufficient action has been taken to incorporate OFPP and the procurement reform objectives into the annual OMB budget and program review process. PPSS recommended that OFPP be fully integrated into the OMB budget process in order to strengthen OFPP's procurement policy role and derive the greatest possible benefit from the establishment of the office.

PPSS also concluded that the policymaking role of GSA in this area should be shifted to OFPP so that GSA can concentrate on

providing efficient and effective support to other Government agencies.

Second, as it relates to improving the organization of the acquisition function within DOD.

Many acquisition-related problems are rooted in the organizational structure of the Office of the Secretary of Defense. For example, major weapons systems are acquired by separate organizations in each of the three service agencies. Each service maintains personnel to perform the same acquisition, management, and administrative functions. PPSS recommended that DOD consolidate the acquisition function, separating it from research and engineering activities in the acquisition process, under a newly created position of Under Secretary of Defense for Acquisition. This would enhance the ability to eliminate marginal programs, something that the services are reluctant to do.

Also, the current DOD organization for contract administration is a combination of centralized and decentralized activities conducted by the Defense Contract Administration Service and by individual service departments. Lack of coordination and variation in operating procedures result in: inconsistency in procedures for evaluating contractor capabilities and performance; inconsistency in the quality of the work force; and the difficulty in applying innovations across service lines.

PPSS recommended that all Department of Defense contract administration functions be consolidated under the direction and control of a senior acquisition service.

Third, as it relates to the area of centralizing the acquisition of "common use" items through GSA.

In fiscal year 1981, total Government procurement was \$134.5 billion, of which \$14.9 billion, or 11.1 percent, were common use items. Of this \$14.9 billion, only \$5.2 billion, or 34.9 percent, was procured centrally through GSA. PPSS estimated that the Government could save \$312 million over 3 years by increasing the number of civilian agency common use items purchased centrally through GSA and recommended that GSA identify items which could be more efficiently and economically purchased through a centralized procurement process.

Fourth, as it relates to lessening the impact of socio-economic programs on the acquisition process.

Eliminating socioeconomic programs which significantly inflate Government costs could save \$12.5 billion over 3 years. There are currently about 80 such programs which stipulate wage rates; working conditions; assisting small, disadvantaged and minority-owned businesses; aid contracts; and on and on.

It is the view of PPSS that a major study of the most pervasive socioeconomic programs ought to be undertaken to seek a means of reducing their burden on the procurement process without altering the achievement of their objectives.

The most important and costly of these programs are the Davis-Bacon, Service Contract, and Walsh-Healey Acts. PPSS recommended repeal of these three acts which would save \$11.7 billion over 3 years. Our estimates assume full implementation. However, the Congressional Budget Office and the General Accounting Office, which use a different timeframe than we used, and use

budget outlays as opposed to authority, supported our recommendation for appeal and concluded that only \$3.5 billion could be saved over a 3-year period, rather than \$11.7 billion that we concluded.

Fifth, as it relates to a most important area that I hope the committee will take time to pursue indepth today, and that is the encouraging of the implementation of OMB Circular A-76 on contracting out commercial and industrial activities.

The Federal Government performs an estimated 11,000 commercial activities, costing about \$20 billion a year, and employing about a quarter of the 1.9 million civilian Federal workers in the United States, or about 500,000 Government positions. But just because Government provides a good or a service does not mean that it should also produce that good or service, especially when the private sector can provide better service at a lower cost.

The Government could save billions of dollars annually through privatization, the movement of functions and activities out of Government, performed and executed by the private sector, or turning Government enterprises over to the private sector or contracting out with the private sector to perform the service rather than doing it in-house.

In 1983, OMB estimated that adhering to the policies set forth in Circular A-76, the Government could save \$5 billion annually after 5 years of implementation.

PPSS recommended: one, the enactment as law the Government's policy of relying upon the private sector for commercial services; two, eliminating the various restrictions Congress has imposed on the executive branch's ability to carry out that policy; three, ensuring that cost comparisons are fairly and accurately conducted. As part of this process, OMB should promulgate new and accurate Federal personnel costs, especially with respect to retirement, which, as you know, currently carries an unfunded liability of over \$500 billion, which is not considered in the equation of determining inhouse costs.

Based upon phased implementation, PPSS projects first-year savings of \$1.15 billion and cumulative 3-year savings of \$7.39. When fully implemented, after 4 years, savings could exceed \$5 billion a year.

As it relates to the sixth item you asked us to look into, simplifying the regulatory requirements.

Procurement regulations are excessive and, in some cases, inconsistent. PPSS recommended that Government use simpler specifications where warranted.

For example, DOD attempts to cover all aspects of the contracting process, such as how to choose among various types of contracts, how to negotiate prices, reporting requirements, how contractors are required to set up their accounting systems and allocate their costs.

In an attempt to provide uniformity in the procurement process, the Department of Defense has created a chaotic regulatory environment which: increases the cost to the Government; inhibits the use of professional judgment by professional contract personnel; increases costs; and effectively prevents smaller contractors from selling to the Government, thereby reducing competition.



PPSS recommendations are to simplify procurement regulations, upgrade the quality of personnel involved in the procurement process, and increase competition.

Item No. 7, enhancing competition in contracting through the use of functional or performance specifications.

PPSS found that the Department of Defense has not adequately addressed the lack of common parts in weapons systems and the excessive use of military specification requirements, rather than normal commercial standards in contracts.

The problem has been that procurement officials are not sufficiently selective in choosing only the particular military specifications that are truly needed.

Savings from enhancing competition in contracting through the use of functional or performance specs total about \$7 billion over 3 years.

As it relates to Item No. 8, improving cost estimates, scheduling, and risk management techniques.

PPSS found and reported three primary areas of weapons systems program management where considerable savings could be realized from improved management methods and procedures. These include improved weapons systems planning, improved contracting procedures, and improved cost estimating and scheduling. In addition, PPSS recommended increased use of "dual sourcing."

To conserve time, rather than discuss each of those four items, let me focus on only one briefly, and that is dealing with dual sourcing.

One of the best ways to increase competition and reduce costs in purchasing is through dual sourcing.

In defense, there is a healthy rivalry during the initial competition for a research and development contract. After this initial competition—frequently awarded based on a firm's "buy-in"—the winner becomes the sole developer and producer for the military system over the next 20 years or so.

Thus, a program, such as a missile system, may have been acquired originally through competition, but after the first step, there is no alternative source for the equipment being produced.

PPSS found that only a small percentage of weapons systems are purchased through dual sourcing, resulting in lost savings opportunities. Dual sourcing could save \$3.4 billion over 3 years in the Navy and the Air Force alone.

The ninth item—increasing stability in the acquisition process through the greater use of multiyear contracting.

Multiyear contracting increases stability in the procurement process, which gives contractors opportunities for long-range planning. This results in lower procurement costs due to economies of scale.

PPSS found, however, that current use of multiyear contracting is very limited and only a few major weapons systems have been approved for multiyear contracting by the Congress.

In addition, the Department of Defense is currently restricted from entering into multiyear contracts for "commercial items."

PPSS recommended expanded use of multiyear contracting in all Federal agencies. In the area of weapons procurement, PPSS noted 31 programs which met the criteria for multiyear contracting, with

potential savings of \$1.6 billion annually possible upon full implementation.

In addition to weapons systems, PPSS found opportunities for multiyear contracting in both defense and civilian agencies in such areas as ADP equipment, photocopying leases, building maintenance services, et cetera.

The last item that you asked us to look into and comment on deals with improving program management by strengthening the role, responsibility, authority and accountability of the program manager.

The Defense Services publish acquisition regulations and guidelines covering program management and the role of the Project Manager. The Project Manager has overall responsibility for the acquisition program. The Project Manager is often provided insufficient support from superiors to adequately fulfill his or her duties and the actual scope of the Project Manager's responsibility often does not include all aspects of the program.

PPSS recommended that the Office of the Secretary of Defense and the Services actively support program managers so that the authority given the Project Manager matches their responsibility.

Before concluding, I would like to summarize the current status of the PPSS recommendations.

The White House has established a review procedure for each and every one of the PPSS recommendations. This includes in attendance at meetings at the White House—the Office of Management and Budget, the Offices of the Cabinet Affairs and Policy Development, and Agency personnel in a review of each PPSS recommendation.

To date, the White House has reviewed 1,153 of the 2,478 recommendations. They have agreed to implement about 82 percent of the 1,153 that they reviewed, or 929. Of those 929, 680 carry with them 3-year savings opportunities totaling \$103.5 billion. Of the \$103.5 billion, they have already implemented \$40.9 billion, and the remaining \$62.6 billion has been agreed to for implementation and it is in the process of being carried out.

Progress to date has been encouraging, but much more remains to be done.

That's why we formed Citizens Against Waste—to educate the public as to the seriousness of the Government's financial condition and to gain their support for eliminating wasteful and inefficient spending primarily through the adoption of the PPSS recommendations.

Our board of directors is indicative of the bipartisan support for which we are striving. It includes William Simon and George McGovern, William Proxmire, and Claude Pepper.

We've already produced 750,000 brochures, delivered hundreds of speeches nationwide, developed a five-part television series that's been seen by more than 15 million people in the last month, published two books, distributed more than 1.5 million pieces of literature since September 1984, appeared on dozens of television shows and provided more than 500 interviews to major newspapers and magazines.

And we're going to do more—much, much more. The chamber of commerce is supporting us, and so, too, are over 100 trade associa-

tions and private sector companies in a joint effort to communicate the message to the American people.

The advertising council has approved us for a \$50 million pro bono advertising campaign which will be initiated in February of this year. We are in the process of mounting the largest and most significant and broadly based education campaign that's ever been undertaken in the history of this Nation.

I emphasize the scope of our undertaking simply to indicate to you how hard we're willing to work to help you reduce Federal spending.

I appreciate the time and the attention the subcommittee has given to the review of PPSS recommendations. The interest shown by you and your colleagues gives us hope that the opportunities offered by PPSS will be fully explored and implemented.

Although PPSS was established by executive order, 73 percent of our recommendations will require legislative action for implementation. In addition, much of the remaining 27 percent will be heavily dependent on congressional support if projected savings are to be realized.

I and my associates have provided testimony before more than 30 congressional committees during the course of the past year and are ready to continue to provide you whatever additional assistance to the executive branch, as well as legislative, to further the understanding, acceptance, and implementation of our recommendations.

Now that I have provided you with an overview of our savings opportunities in the general area of procurement, I would like to ask Bill Tremayne to take a few brief moments to discuss one of those opportunities in greater detail, one which concerns this committee. And that deals with the organization of the acquisition process within the Office of the Secretary of Defense.

A few brief moments—Bill?

Mr. TREMAYNE. Thank you very much, J.P.

I appreciate very much the opportunity to explain in further detail this key recommendation that was made by the OSD Task Force.

I might also add, Mr. Chairman, that the members of the executive committee of the PPSS who worked with the OSD Task Force—Bob Beck of Prudential, Jim Burke of Johnson & Johnson, Carter Burgess, former Assistant Secretary of Defense, and Carl Covitz of Landmark Industries—and I had the benefit of a meeting with you prior to commencing our review of OSD. The insights that you provided were extremely helpful to us in lending focus at that point, as we were just beginning what seemed an enormously broad charge to discovering major cost savings opportunities in the Department of Defense.

Mr. Bolduc has already discussed a number of the recommendations that were made by the OSD Task Force, as well as other task forces that dealt with procurement. I believe that they have a great potential to simplify the procurement process, while saving many billions of dollars annually. A worthy objective at any time, but particularly now, as you wrestle with the challenge of reducing Federal budget deficits.

As I mentioned, this morning I would like to elaborate on a key recommendation mentioned by Mr. Bolduc. This is issue OSD-15 in

the report of the OSD Task Force, entitled, "Improved Organization of the Acquisition Function."

We have recommended that DOD should consolidate the acquisition function—separate from the research and engineering function—under a newly created position of Under Secretary of Defense for Acquisition, thus providing more professional attention to the procurement and production phases of the acquisition process, those phases in which more than 80 percent of the procurement dollars are spent.

We believe that this change would bring much-needed discipline to the acquisition process within DOD. It would require that designs be completed and accepted before major procurement and production begins, rather than tolerating endless tinkering.

An even more far-reaching recommendation, yet, one that we feel is completely warranted—is the total consolidation of the acquisition function at the OSD level. Under this proposal, all research and engineering functions would be consolidated by the Under Secretary of Defense for Research and Engineering. The purchasing or procurement and production functions would be consolidated by the Under Secretary of Defense for Acquisition.

The present research and engineering functions would be removed from the services. Under this proposal, the services would determine mission needs, conceptualize countermeasures, develop mission element needs statements, and charge the acquisition agency within OSD with development and production of weapons systems to meet these needs at minimum cost and on an agreed schedule. The services would retain the functions of test and evaluation for acceptance of the final system.

I should note that calling for consolidation within OSD does not preclude the use of effective decentralization among a variety of lines, such as the type of product being produced. The two concepts are not mutually exclusive.

Adoption of the proposals that we have recommended would yield significant efficiency and cost reduction benefits. They would lead to significant alleviation of program instability and the excessive number of new starts that we currently experience.

I was gratified to learn last year that Senator Roth, chairman of your full Committee on Governmental Affairs, had reached the same conclusions that we had. While his suggestions were predicated on a GAO study released more than a year after our review, the specifics of his recommendations square precisely with those that we have suggested.

Citing similar problems with respect to cost estimating and reporting, Senator Roth said, and I quote, "the best way to curb cost growth and improve the management of major weapons programs would be to turn the procurement of major new weapons over to a centralized agency in the Pentagon staffed by civilian procurement professionals."

Senator Roth also said that he was "becoming convinced that we will not be able to change attitudes and ensure cost effective management unless we make fundamental changes in our acquisition system."



Gentlemen, I hope that a full reading of our report on this issue and thoughtful consideration of its consequences will be convincing to you as well.

My latest understanding was that Senator Roth would probably be urging action on his proposal during this session. I hope that you will be able to be supportive of this consolidation proposal as well as our further proposal to separate the acquisition function from the research and engineering functions.

And I should add parenthetically that I hope you will be able to support all of the recommendations covered by Mr. Bolduc as well.

I'll be pleased to answer any questions that you might have.

Senator COHEN. Thank you very much.

I'd like to yield to each of my two colleagues who form this trinity of Senators Against Waste. [Laughter.]

I don't know of any two people who have worked harder on this committee than Senator Levin and Senator Chiles, and on the floor itself, leading efforts and supporting efforts to curb wasteful spending.

So I'd like to yield to, first, Senator Levin, and then Senator Chiles.

Senator LEVIN. I don't have an opening statement, Mr. Chairman. Just to welcome these gentlemen and, of course, we'll have some questions a little later. We commend them for their efforts. Trying to root out waste in Government is something which I think we're all dedicated to. Many of us give a good portion of our legislative lives to trying to achieve this, and we need all the help we can get. We thank you for that help that you're providing.

Mr. BOLDUC. Thank you.

Senator COHEN. Senator Chiles?

#### OPENING STATEMENT OF SENATOR CHILES

Senator CHILES. Mr. Chairman, I applaud your initiative in calling this hearing. I certainly thank you for permitting me to participate.

The Grace Commission has focused a lot of attention on the need to eliminate waste. It continues to mobilize public support for those changes.

I think that that is very, very healthy and I'm delighted to see that. My view is that Congress should implement those recommendations that call for changes in the law where Congress feels that that's the wisest thing to do.

Through its oversight function, Congress should apply similar logic and encourage the executive branch to eliminate those changes that can be accomplished without new laws.

I think, also, Mr. Chairman, that the Congress has the responsibility to point out those assumptions and recommendations that perhaps can't be accomplished, or perhaps are somewhat overstated.

I'm delighted to see the testimony today that there is a difference and you've cited the difference between what the CBO says could be saved and certain of the recommendations.

My fear is that we've gotten the numbers out there so big in the minds of the general public, that if we come up with all of these



recommendations and come in with smaller dollars, we're again going to find our credibility impinged upon.

I think we have to be careful that we don't try to raise false expectations.

Federal procurement policy is now a \$168 billion issue. A 10-percent savings, certainly something that's not unheard of in the area of administrative efficiencies, amounts to \$16.8 billion. That's why I think your focus on the procurement recommendations of the Grace Commission is particularly important, Mr. Chairman. It's also timely. For with the new administration and a new Congress, trial balloons, like the trial balloon to abolish the Office of Federal Procurement Policy, are already being floated.

Procurement reform is something that this committee and the House Committee on Government Operations has worked on intensely since Chet Hollifield and Scoop Jackson held hearings on military cost overruns in the late 1960's.

From the procurement commission to the creation and reauthorization of the Office of Federal Procurement Policy, to the completion of the Competition in Contracting Act of last year, some of us have been toiling in the field for a long time.

I think, Mr. Chairman, it should be noted that you led the battle for the reauthorization of the Office of Federal Procurement Policy just last Congress. President Reagan signed that law. Senator Cohen was also key to the Competition in Contracting Act last year, and President Reagan signed that law.

Here we are in a new Congress and a new administration and up goes the trial balloon.

I'm eager to get a sense of whether the Grace Commission folks believe that we need a strong Office of Federal Procurement Policy with a statutory foundation. I'd like to know whether they think the committee's recent and past contributions to procurement reform are consistent with their recommendations. Or do we need to take a whole new tack?

I'm eager to hear Joe Wright tell us what the plans for the Office of Federal Procurement Policy are.

My experience has been that the deliberations surrounding the creation and reauthorization of this organizational focal point for procurement reform has been less political, less partisan, and more substantive than those bureaucratic turf struggles surrounding proposals for its end.

I might be way off base this time, and I hope that Joe Wright can start a dialog.

Government contracting has gotten a lot of negative press attention in the recent past and no one supports waste and fraud. Certainly the President knows how to lead and what symbols are meaningful.

I have difficulty understanding how the present set of symbols surrounding the Office of Federal Procurement Policy can be viewed as a step forward.

The worst part of the punishment placed on Sisyphus, Mr. Chairman, was that he had to push that boulder uphill forever and forever. He was not allowed to die of old age.

I'm delighted to participate in your hearings this morning.

Senator COHEN. I'd only add to that that the existentialist philosopher Camus said we must consider Sisyphus as being happy. [Laughter.]

Senator LEVIN. I don't have anything to add. [Laughter.]

Senator COHEN. Let me move to some questions, Mr. Bolduc. The first one being that Senator Chiles has raised the issue that both the Congressional Budget Office and the General Accounting Office have indicated that the Grace Commission's cost savings are somewhat inflated. The CBO and GAO criticize the Commission's assumption of a 10-percent inflation rate when, in fact, the good news yesterday was that we're under 4 percent.

I believe Mary Ann Gilleece, who is the Deputy Under Secretary of Defense for Acquisition Management and will be testifying a little bit later, is more blunt. She says that your projected savings are "grossly overstated."

I was wondering, what have you done to take into account the criticism coming from GAO, CBO, and experts such as Ms. Gilleece?

Mr. BOLDUC. I think the first thing, Mr. Chairman, we need to place a couple of issues in perspective. Let me address first the 10-percent inflation rate.

You will recall that the work of PPSS was initiated in the spring of 1982, when we were still at an inflation rate of 14 percent. In order to be able to assure that we had reasonably defensible, cost-saving projections, we had to develop a procedure and a system, because we had 2,000 people out in the trenches of the Federal Government making review and analysis and drawing conclusions.

Therefore, we used a conservative 10 percent, which was conservative in the spring of 1982. We went to the Office of Management and Budget and got their concurrence that the 10 percent inflation rate, given the information that we had available at that time, was realistic.

Even if you were to take—let's assume that we are dead wrong with the 10 percent and let's reduce it to 5 percent, which is—what is it annualized now; 4.8 percent?

Let's use the 5 percent. The total impact, difference, is what, John; \$5 billion?

Mr. GISH. It's about \$10 billion.<sup>1</sup>

Mr. BOLDUC. A \$10 billion difference. So you would reduce \$424.4 down to \$414. So we're really talking about something that, in my view, is not that significant one way or the other.

The point I wish to make is that we were justified, based on the information that we had at that time.

The second point dealing with CBO and GAO. I made several points—

Senator COHEN. Could you stop just for a moment?

Mr. BOLDUC. Sure.

Senator COHEN. I'm not sure of the mathematics. In other words, your assumed inflation rate was triple of what we're presently operating under. If you cut the inflation rate by two-thirds, you say you're still only saving \$10 billion?

<sup>1</sup> Mr. Gish subsequently informed the subcommittee that this figure should be \$20 billion, which would also reduce the overall projected savings to \$404 billion.

Mr. GISH. To reduce it by approximately \$10 billion. It's certainly not a significant——

Senator LEVIN. We can't hear you.

Mr. GISH. In fact, we have previously submitted to each Member of Congress our analysis of the CBO-GAO review and we pointed this out. There was also a document that was produced late last year which was a review by the Democratic Study Group. This contained the same sort of information. We, again, provided rebuttal.

We have provided short rebuttal. We have provided long rebuttal. We keep getting the same points over and over and over again.

Quite obviously, CBO-GAO did a review within the timeframe that they had and admitted that they did it within the constraints of the Federal budget system. Well, the Federal budget system is not terribly representative of actual activity in Government.

If we were to try to use it in the private sector, we'd be out of business. Or in jail. One or the other. You can look at Federal spending and you are underestimating it by at least \$400 billion. I mean, this is the way in which they keep the books.

We've looked at specific loan programs, for example. In just one area, in the Farmers Home Administration, we looked at the agricultural credit insurance fund. Well, we were told that they had actual spending of about \$1½ billion. When we looked at it, we saw \$13.5 billion. That's because the Government, under GAO's accounting system, one which they disagree with, by the way, and are trying to implement change—but under the existing accounting system, under the accounting system that GAO was functioning under, they'd only report \$1½ billion because they net receipts against payments. Or in the case of the agricultural credit insurance fund, they take billions of dollars of loans, sell it to the Federal Financing Bank, and it's gone from the budget.

It's as though it were never there.

So that if we implement, or recommend a change which is going to reduce spending, it's quite conceivable that our saving estimate will be more than the total spending in that particular area because of the accounting system.

Mr. BOLDUC. But I think that you will find, Mr. Chairman, as you well know, that the budget process deals with budget authority, budget obligation, and budget outlays. And at any one point in time, your obligation is 42.5 percent beyond your outlays. And we dealt with the commitment, as we would in the private sector. It is not only important what you're spending, but what you've committed to spend.

Let me address very specifically the CBO-GAO review. They were asked by Senator Domenici's committee to review potential savings opportunities in three specific fiscal years—1985, 1986, and 1987. They were asked to exclude any savings opportunities before that time or after that time.

They reviewed 16 percent of our recommendations. They did not review any recommendation that had a savings value of less than a billion dollars.

Even with those qualifications—for example, the \$58 billion we had in savings with respect to military and civil service, which would not be implemented in some cases until the year 2000, were excluded from the review. The \$57, \$58.9 billion we had with re-

spect to poverty programs, for which only 30 cents gets to the poor and 70 cents goes elsewhere—administrative costs, fraud, waste, and abuse—that \$59 billion was excluded from their review because it would be implemented after 1987.

Even with those qualifications, they did confirm \$97.9 billion, in 3-year savings.

So the issue of GAO-CBO has not been placed in the proper perspective, in my view, and has not been portrayed by the media as an accurate characterization of what has happened.

Senator COHEN. You mentioned during your opening statement that you were concerned about the Office of Federal Procurement Policy. What is your reaction to the administration's proposal to merge the OFPP into the OMB?

Mr. BOLDOC. Mr. Chairman, let me give you a very quick bottom-line reaction. If you're going to establish an office or an agency in government or in the business sector, you either give it teeth and authority to operate, or you don't have it around.

OFPP has a responsibility, but without the authority to go along with it. You either ought to have OFPP within OMB as a fully integrated unit in terms of budget review and development, as part of the management process in the management side of the Office of Management and Budget, or you ought not to have it. Or you take that policy role and put it into the General Services Administration.

I get a little heartburn when you do that because you're now commingling policy development and monitoring with execution of those policies. But there is a need in Government for the development of policy and the monitoring of execution of that policy. And currently, OFPP has the responsibility to do it, but no authority. So the bottom line is either they're given authority to do it or you do away with it.

Senator COHEN. I would just point out that last year, we went through a fairly lengthy battle over the issue of whether to give OFPP regulatory authority, which was the original design of OFPP. As a result, the OFPP reauthorization was almost torpedoed on the Senate floor.

So the effort was made to, in fact, give the OFPP the teeth that you say had been missing. I find it somewhat ironic that just a year later, after OMB testified in favor of the reauthorization of OFPP, and after the American Bar Association every major organization testified in favor of giving the Office separate identity and additional powers, the administration is coming in and saying, we ought to merge it with OMB.

I find that inconsistent with your recommendation that we need a strong, central procurement policy office.

Senator CHILES?

Senator CHILES. Well, I do, too, and especially if you look back at history. Basically, it was a misnomer to call OMB OMB. There was no "M." There was no management. And that was certainly the reason and part of the thrust out of the procurement Commission thinking. The need for stronger management was behind our efforts to create an office of OFPP.

Now, the office has always been handicapped. People are constantly trying to strangle its power. At one time we thought about



making it a separate agency in the Office of the President. We decided it had to have the clout of the budget process. We finally put it into OMB. We wanted it to have a separate line item for its budget, so it could not be strangled.

That's been a continual fight. We wanted to have the director appointed by the President and confirmed by the Senate, to try to give some status. Again, we have always said that they should report, not only to their office and to the President, but also to the Congress. So we were trying to give it some authority that way and get Congress into the act of being able to see what was happening in some of these management functions.

It has provided an ability to provide oversight through oversight hearings we've been able to hold on OFPP. And if you look at its recommendations, every time it tried to go and really do something, to merge some of these procurement policies, to try to see that Defense didn't go entirely its own way in its procurement policies, huge battles take place.

To say now that we're going to abolish it, we're going to put it back into OMB, I think is just to take the "M" out again. I think that that would be the worst kind of situation that we could go to.

I would like to see the Grace Commission talking about giving it teeth. That's what Congress has wanted to do. That's been the thrust of this committee. I don't say all of Congress because there are always people that somebody can call and say, wait a minute. We've got to whack this down a little bit, either in the administration or someone else.

Mr. BOLDUC. I think, Senator, that your points are absolutely on target and consistent with what we have said. But I think the problem of management in Government goes beyond just procurement.

We recommended the establishment of a Federal office of management because we felt as you have—if you take a look at the way Government is organized today, you have Don Devine at the Office of Personnel Management reporting in to the President. You had Jerry Carmen and now Ray Kline acting at GSA reporting in to the President. You have OMB reporting in to the President.

The fact is that there is no good office that develops management policy and monitors execution. You have the commingling arrangement. You have GSA involved with policy development and execution and some phase of monitoring. You have the Office of Personnel Management that establishes classification standards in terms of policy, salary scales, and they go down and, in fact, do the review and the assessment for the individual agencies.

There's a built-in conflict. And I think what you're talking about in procurement, whatever it is that you decide to do at OFPP, ought not to be done independent of the role that the GSA continues to play in the procurement process, because there is overlap. There is duplication. And there is inconsistency between those two offices currently. But you're right—OFPP does not have the teeth to do what it needs to do.

Senator COHEN. Mr. Tremayne, you've recommended that we reorganize the Defense Department's acquisition policies. Ms. Gilleece is going to be testifying in a few moments that she thinks that it's really "false economy to attempt to reorganize your way out of problems" and that, in fact, the Grace Commission does not



cite any savings as a result of this reorganization. I think you indicated, or Mr. Bolduc indicated, that \$1.4 billion could be saved over a 3-year period.

Mr. TREMAYNE. That was part—there were two recommendations swept together and the numbers were only with respect to the other issue rather than the one for improving the acquisition function.

As was noted in our issue, we felt that very considerable savings would be available. But contrary to what you sometimes hear, we had a great desire to be as accurate as we could be and conservative in putting together the numbers.

This one is so far reaching, that while we think a great deal of savings would be achievable, it would depend on the form and exactly how it worked. We did not have the time to quantify it. I do think that a great amount of savings—and some of it would be accomplished by managing the other issues that we recommended in a more efficient manner.

Mr. GISH. Mr. Chairman, may I just add something? The existing system has given us the \$436 hammer, the \$1,000 plastic stool cap, the \$9,600 hexagonal wrench that you probably have all seen and are probably bored with seeing.

But the important point to note is that these are not overpriced, not within the existing system. In fact, in June 1984, the DOD Inspector General came out with a report that said that 94 percent of the parts that they were acquiring were reasonably priced. And this includes these kinds of items.

It's the system that's giving you this. It's the entire structure that's giving you this. And that's the kind of results you're getting.

You've had Navy flag officers explaining how they paid \$436 for a hammer and saying this is right. I have the breakdown on the \$1,000 plastic stool cap. But it's all given to you by the system, given to you by existing regulations, and given to you by the existing structure. So that when someone approaches you later in the day and says that there are no savings to be realized, take a look at these individual items and remember the spare parts are just specific examples that were brought out because people can relate to it.

Maybe they can't relate to an M-1 tank, but they can relate to a hammer and they can relate to a wrench. That overpricing is pervasive through the system and it results from the organization and the regulations that are being promulgated.

Senator COHEN. Mr. Tremayne, OSD and each of the services have their own independent cost groups to improve the accuracy of cost estimates for major weapons systems. Do you find that these independent groups more accurately project cost estimates?

Mr. TREMAYNE. There was a variance in the experience there. Our recommendation was that they take the more conservative approach in the estimates and take an analysis of them. There were times when they were higher or they were lower.

Senator COHEN. Well, what would you recommend? Taking the more conservative approach and taking the higher figure rather than the lower?

Mr. TREMAYNE. If there was a difference that could not be reconciled, I think that certainly safety, and history, would indicate that

you can never be wrong by taking the higher figure—at least seldom be wrong. And if there is ample evidence to support that, I think the higher figure should be taken for conservative reasons.

However, our basic recommendation would be, I think, very helpful in that it would have the services testing the OSD unit that we recommend, that there would be a healthy tension between the buyer, who would be the services, and the provider, which would be the OSD element.

This recommendation, while it may seem radical, is, in many respects, a continuation of the reforms that were being put in place by President Truman and President Eisenhower working with the structure as it existed shortly after the department was created. And all of this history—maybe not all of it—but a substantial amount is covered in our report. I've not incorporated it into this morning's testimony.

Senator COHEN. There seems to be some inconsistency within the Grace Commission itself as pertains to the OSD task force. They found the independent cost estimates to be valuable. The procurement task force did not. How do you reconcile that?

Mr. BOLDUC. I'm sorry. I didn't hear that, Mr. Chairman.

Senator COHEN. There seems to be some inconsistency between the various task forces within the Grace Commission itself. The OSD, the Office of the Secretary of Defense, task force found the independent cost estimates to be of value. The procurement task force found them not to be of value.

Mr. BOLDUC. What we did, Mr. Chairman, you have to go through such an experience to appreciate what I'm going to say. But if you take a look at Government in terms of vertically integrating—

Senator COHEN. Well, who do we believe, I guess is what I want to—

Mr. BOLDUC. I don't think it's a function of believing. I think it's a function of understanding what we tried to do, because there are vertically integrated functions in Government and there are horizontally integrated functions.

When you get into the vertically integrated function, there's no problem. You assign a group to take a look at that operation, its characteristic, its procedures, its practices, its methods and controls.

When you get into procurement, you overlap every Government agency. And what we had to do, given resources, given the time-frame, given the Department of Defense, as opposed to civilian agencies, we met on a frequent basis consistent with the plan that we had developed and agreed that because of timing and because of areas that the procurement task force was going to look at GSA, that the Office of the Secretary of Defense task force would report on the acquisition process within DOD.

So we identified areas and assigned them and the report came out reflecting their findings and conclusions on the basis of assignments. In some cases, there's overlap; in other cases, there is not.

Senator COHEN. What about the inconsistency? I'm not concerned about overlap. I want to know whether these cost estimates, the independent cost estimates, are valuable or not. What's your conclusion?

Mr. BOLDUC. Give me a specific.

Senator COHEN. Well, you're the one who filed the recommendation. That's a summary of your Grace Commission report there and within that summary, you've got two different task forces, each of which comes up with a different conclusion.

So for those of us who are in a position of trying to make changes, we want to know which way do we go? Do we insist upon more independent cost estimates or do we say they really are simply duplicative. They use up a lot of man-hours and so forth, and don't save that much money. That's one conclusion by the procurement task force. The other task force says, no, we ought to do it. I just want to know what do we do?

Mr. BOLDUC. But the procurement task force report concentrated on civilian agencies, as opposed to DOD.

Senator COHEN. So we should have it just with respect to DOD and not to civilian agencies?

Mr. BOLDUC. I think you will find that the primary thrust of the procurement work was focused on civilian. They did do some work in DOD, but the principal call in the procurement area as it relates to DOD should come out of the DOD-based task force reports.

Mr. TREMAYNE. I think, if I may, Senator, I believe the same people who they talked to and we talked to tried to convince both of us to retain the structure or to take the position that they aren't necessary. They may have been convinced—we went into it, I think a little further. We did come up with a recommendation that the responsibility be shifted, but that the function be retained and that this conservative approach in evaluating differences between service estimates and the independent estimates be followed for conservative practice.

Senator COHEN. Senator Levin?

Senator LEVIN. Thank you, Mr. Chairman. The DOD representative this morning, as has been indicated, states in written testimony that they believe that the savings which the Grace Commission projects are grossly overstated. And she gives three basic reasons for why that has happened.

She says that the estimates, in most cases, are highly subjective and, in their opinion, optimistic. Second, that they are duplicated from one section to another, frequently. And third, that they didn't credit savings which would have accrued anyway as a result of the internal improvements which have been put into place.

I'd like to just go through those with you. One, are the estimates subjective?

Mr. BOLDUC. I don't believe so, not with the kind of documentation we have. I think that what we have found is that in almost every case where someone doesn't necessarily agree with the recommendation, they take one of two positions: (a) that the savings are grossly exaggerated and, therefore, we can't do anything to realize those kinds of savings, so let's forget about it; or (b) that the matter is a policy matter, as opposed to an administrative matter, and that the Grace Commission, quote, unquote, purportedly overextended its authority and looked at the policy.

Senator LEVIN. You'd tell us——

Mr. BOLDUC. I'm sorry?

Senator LEVIN. I was just wondering if you could tell us how the Grace Commission estimates the savings? Let's just take one particular example, if you would.

The one which is attached to her testimony. I don't know if you have her testimony in front of you, but it's your OSD No. 22 and your procurement section No. 8 on improving cost estimates.

You've given us there a savings of \$7.185 billion over 3 years. And that's combining your Nos. 22 and 23. Now if you could just take a look at those two numbers, 22 and 23, combined, give you an estimate of \$7.185 billion.

Now that is made up of a lot of subitems, as we understand it.

Can you just go through your process as to how you arrived at \$7.185 billion?

Mr. BOLDUC. Let me first respond by saying that I had 2,478 of these to review. And to give you, off the top of my head, how we came up with the number is like trying to stick my finger up in the air and do a little Kentucky windage. I will be happy—

Senator LEVIN. You're not personally familiar with that one, with these particular items?

Mr. BOLDUC. I think Bill has some familiarity with it. But I would be happy to submit for the record how we arrived at those because in no case did we simply—you know, these cost estimates were not derived on the corner of 16th Street and E at 9 at night and said, I think we're going to come up with \$7.1 billion.

There was a great deal of analysis and review and documentation. Where there is a difference, and I'll be the first to acknowledge this, if you walk in, and let's take a very simple illustration—I walk into an operation with 100 people. We make an analysis and evaluation of a process of the work. We go back to our own backgrounds in the private sector and say, if this process was automated, we could reduce  $x$  number of people. If this office was consolidated with another one, we could save  $x$  number of dollars. We come from a different environment of having to meet a payroll on a Friday night and we're not afraid to make a tough decision. I have served in the public sector—

Senator LEVIN. I'd like to get to the specifics, if you can. If you don't have them, maybe Mr. Tremayne can give them to me.

Would you agree that, necessarily, these projections involve estimates of savings?

Mr. BOLDUC. Would I agree what, now?

Senator LEVIN. That these projected savings necessarily are estimated?

Mr. BOLDUC. We have provided in every single report we released, in the front, there's a paragraph that explains (a) how we arrive at the calculation—

Senator LEVIN. I'm just asking you, are they necessarily estimates?

Mr. BOLDUC. Yes, they are, and they're identified in each report. They are estimates. They do not have a level of precision as a budget number does.

Senator LEVIN. Are you saying that there's no subjective element at all in those results?

Mr. BOLDUC. I absolutely would not say that.

Senator LEVIN. OK. So there's some subjective elements.



Mr. BOLDUC. Absolutely.

Mr. TREMAYNE. Senator, may I—

Senator LEVIN. No; that's all I wanted to know. I just said that the one reason she gives is that they're subjective. And now you're saying that there are subjective elements. So—

Mr. BOLDUC. Of course. There has to be. The same way there is with anybody else's estimate.

Senator LEVIN. I agree with you. But at first you said that they weren't subjective and now—

Mr. BOLDUC. No; I didn't say that they weren't. I didn't say that they weren't. My point is that in most cases—I should say in all cases—we went through a very detailed, deliberative process. But in that process, there were certain subjective judgments made.

Senator LEVIN. Fine. That's all I wanted to know. Necessarily, you would say that there were some objective elements, but there are some subjective elements; right?

Mr. BOLDUC. And I might also add, by the way—

Senator LEVIN. Is that right?

Mr. BOLDUC. I'm sorry?

Senator LEVIN. Is that a fair statement?

Mr. BOLDUC. Sure it is. Sure it is.

Senator LEVIN. OK.

Mr. BOLDUC. But I think it's also important to point out that with 332 incompatible accounting systems in Government, with the lack of data that is simply not available to do the kind of cost estimates that need to be done, there's a lot of subjective assessment not only in our estimates, but in the response of any agency that comes forward and says, you're wrong. Instead of \$2 million, it's \$1 million—and we ask them, show me—they're not showing us any better numbers than what we were able to come up with.

Senator LEVIN. I understand. OK. Second—

Mr. TREMAYNE. Senator, may I just address that since you asked for someone who worked on this report to comment on it?

In giving the background for this information, we have pointed out that simply taking a sampling of 25 major systems, where the total development estimates at the onset of the various projects that had started at different times were \$104.8 billion, the ultimate cost was \$339.2 billion. That even after you took unanticipated inflation out of the program, the cost escalation was 183 percent of the original development cost.

Based on all of the work that is quantified here, we estimated that savings by reducing instability, better estimation and such, could range between 5 and 10 percent. We took 7.5 as an average.

Yes, that is an estimate, but it was based on material that led up to it and we were explicit as to how the estimate was determined. If you're saying between 5 and 10, with numbers this big, that's a large range. We acknowledge it's a large range, but we explained the basis of our estimates for each of them.

Senator LEVIN. All right. So—

Mr. TREMAYNE. If we got to military retirement, we had an actuary do a precise estimate and those figures would be more accurate than those that say a range from 5 to 10.

But we explicitly say what we estimate.



Senator LEVIN. So that in your OSD No. 22, is that the one you were referring to when you said 5 to 10 percent?

Mr. TREMAYNE. Nos. 22 and 23, the estimate was combined in OSD-23 on page 206, and it says that.

Senator LEVIN. Fine. Right.

Mr. BOLDUC. Mr. Senator, could I—

Senator LEVIN. The process that you used in OSD-22 and 23 was you went through your proposed savings, ways of saving money, then estimated that you could save 5 to 10 percent of that delta and then took 7½ percent as an average. Is that right?

Mr. TREMAYNE. And said so. We just didn't come up with the number.

Senator COHEN. Can I say—

Senator LEVIN. Yes.

Senator COHEN [continuing]. Using the word "estimate," it's not being used in any pejorative sense.

Mr. TREMAYNE. I understand.

Senator COHEN. I mean, the Defense Department, every department estimates what they're going to spend for a particular system. So it's not any criticism of the Commission that you are estimating savings, any more than a criticism of the Government estimating what it's going to cost. So we're not trying to in any way back you into a corner, but, rather, find out whether there's any legitimate criticism of the Grace Commission's analysis.

Mr. BOLDUC. Sure. I hope we're not reacting in a defensive way, Mr. Chairman. What has happened is that we have been misunderstood. And let me, for example, read two sentences from every report. Whether it is the Congress or the media, I have yet to find anyone who says, yes, I read the report—

Senator LEVIN. Can you submit that for the record because I've got a number of questions here and I only have a limited amount of time.

Mr. BOLDUC. Go ahead.

Senator COHEN. Your time is up.

Senator LEVIN. My time's up. [Laughter.]

Senator COHEN. Go ahead. [Laughter.]

Mr. BOLDUC. Go ahead.

Senator LEVIN. So we'd be happy to have that for the record, as to how you misunderstood and misconstrued to be helpful, or the reactions to it.

Mr. BOLDUC. OK. I will. I'll submit it for the record.<sup>1</sup>

Senator LEVIN. The second reason—

Mr. BOLDUC. I'm just hopeful that somebody reads it.

Senator LEVIN. We do.

Mr. BOLDUC. OK.

Senator LEVIN. You can be sure that in this case I will, anyway.

Mr. BOLDUC. OK. I'll send you a special letter to make sure that you do. [Laughter.]

Senator LEVIN. All right. And I'll send you a special confirmation that I have. [Laughter.]

<sup>1</sup> See p. 284.

Next, she says that the estimated savings are duplicated often. And I'm wondering if you could indicate whether or not you would agree that there is some overlap in these recommendations?

I pick the words advisedly. Is there some overlap?

Mr. BOLDUC. I knew that that was going to be the next question and let me now read that one sentence.

Senator LEVIN. Well, why didn't you answer it before I asked it, then? [Laughter.]

Mr. BOLDUC. Because I didn't want to embarrass you, you see. [Laughter.]

Senator LEVIN. You're always trying to stay ahead of me. Why don't you just answer it. [Laughter.]

Mr. BOLDUC. Every report states:

It is important to note that cost savings, revenue and cash acceleration opportunities in this report may duplicate similar dollar opportunities reported in other task force reports; thus, there may be instances of double counting of dollar opportunities between task force reports. These duplications will be netted out in the final summary report to the President.

And they were.

Senator LEVIN. Fine. My question to you is, In other words, there is no overlap, then, in terms of the net savings that have been given to us of \$424 billion?

Mr. BOLDUC. Correct.

Senator LEVIN. OK. That was only my question.

Mr. BOLDUC. The overlapping number was \$545 billion.

Senator LEVIN. OK. And is that something that you could supply for the record so that we can see where——

Mr. BOLDUC. I would be happy to give you a complete listing of each one of them and where they overlap.<sup>1</sup>

Senator LEVIN. Thank you.

Now, there were about 2,400——

Mr. BOLDUC. And 78.

Senator LEVIN. 2,478 recommendations. And as I understand that figure, and this will be my last question since I am out of time, 73 percent of the projected savings require congressional action; is that right?

Mr. BOLDUC. Right.

Senator LEVIN. But is it also true that only 29 percent of these recommendations require congressional action?

Mr. BOLDUC. Twenty-seven percent.

Senator LEVIN. Twenty-seven percent.

Mr. BOLDUC. I'm sorry. Only 27 percent by the executive branch, 73 percent by the Congress.

Senator LEVIN. Now, I'm talking about, though, on the actions that are needed to produce the savings. I'm not talking about the savings, now. I'm talking about the actions necessary.

Mr. BOLDUC. The individual recommendations as opposed to dollar savings.

Senator LEVIN. Yes.

Mr. BOLDUC. I don't——

Mr. GISH. It would be a substantially higher percentage of the recommendations that would be under administration control be-

<sup>1</sup> See p. 284.

cause a lot of the small items—there are a lot of recommendations with limited dollar savings.

Mr. BOLDUC. You're probably right. It's probably the complete reverse. But I should point out——

Senator LEVIN. Shouldn't you mention that in your testimony? Isn't that important?

Mr. BOLDUC. It is and it isn't. And let me tell you why I think that it isn't. Because we have had——

Senator LEVIN. I'd rather you tell us why it is.

Mr. BOLDUC. Well, I will, before you leave. [Laughter.]

We have had numerous recommendations that the administration has sent up to the Congress for which they have authority to execute, but it's been part of the budget process for which the Congress has rescinded and said, no, you will not implement. No, you will not close an office. No, you will not consolidate. No, you will not take overlapping and duplicative functions and clear them out.

We view that as an executive authority for which you pay a senior manager \$70,000-plus a year to function, and the Congress comes in and says, no, you cannot. So those percentages——

Senator COHEN. Merging the OFPP into OMB, would that be the kind of decision that you would like to see implemented?

Mr. BOLDUC. No, no.

Senator COHEN. Congress has a role in that?

Mr. BOLDUC. I think OFPP—Congress established the organization. Certainly, they do. But I think when it comes time to establish a boundary for the Forest Service or to contract out functions and services, that ought to be a decision that rests with an executive within an executive agency and not the Congress.

Senator LEVIN. I wonder if you could, for the record, give us the figure as to what percentage of the actions that are needed are legislative and what are executive.

Mr. BOLDUC. I'd be happy to do that.<sup>1</sup>

Senator LEVIN. You've given us the figure on what percentage of the dollars have to be created by executive and legislative action, but if you can give us the figure on the actions——

Mr. BOLDUC. Sure.

Senator LEVIN. I have a number of other questions for the record. I'm wondering if you would be willing to answer a few additional questions.

Mr. BOLDUC. Absolutely.

Senator LEVIN. Then you can give us whatever additional information——

Mr. BOLDUC. No problem.

Senator LEVIN. I'll give you an open-ended question so that you can put whatever else you want in the record.

Mr. BOLDUC. Wonderful. Wonderful. [Laughter.]

I usually cash in on those opportunities. [Laughter.]

Senator LEVIN. Thank you.

Senator COHEN. Mr. Bolduc, Mr. Tremayne, Mr. Gish, thank you very much. I would point out to the people in the audience that

<sup>1</sup>See p. 284.

Mr. Bolduc is holding in front of him a bible, which I assume is a summary of the Grace Commission's recommendations——

Mr. BOLDUC. Well——

Senator COHEN [continuing]. Which occupy some 400 and some odd pages. The summary alone, as I understand, of the Grace Commission is over 400 pages.

Mr. BOLDUC. No; it's 600.

Senator COHEN. It's 600.

Mr. BOLDUC. It's 600.

Senator COHEN. So that gives you some indication of the kind of work that he and the other members have put into the job studying the Federal budget process and why he and the others feel so strongly after spending a year or two of their time analyzing what is a massive or monstrous task, why he feels so eager to explain in every detail the rationale underpinning the recommendations.

But we will look at your answers very carefully, and we do have to move on because we have a number of other witnesses, including Mr. Wright, Ms. Gilleece, and others, who are eager to come before us and tell us how they're saving money based upon the Commission's recommendations.

Thank you very much.

Senator LEVIN. Mr. Chairman, I would also like to add my thanks to Mr. Bolduc and his colleagues, the members of the Grace Commission, the staff over there.

As I indicated, we need all the help we can get. This is a massive job to root out waste in this Government. The Grace Commission report has been of tremendous help to the Congress so far and will be even more help. And while it may not quite compete with the Bible in terms of guidance, in one sense, it really is a plan for some significant action to reduce waste in the Federal Government.

I want to commend you and your colleagues for it.

Mr. BOLDUC. Thank you very much.

Senator COHEN. Mr. Tremayne, if you could—I don't know what your schedule is, but if you could wait and listen to some of the other testimony, I think we'll be dealing with a couple of areas of your recommendations.

Mr. TREMAYNE. I would be delighted to, sir.

Senator COHEN. Fine.

[Prepared statements of Messrs. Bolduc and Tremayne follows:]



Testimony of Mr. J. P. Bolduc  
Before The Senate Subcommittee  
on Oversight of Government Management  
January 23, 1985  
Dirksen Senate Office Building - Room SD-342

Mr. Chairman, I am pleased to accept your invitation to discuss the work of the President's Private Sector Survey on Cost Control (PPSS) and to identify some of our major recommendations related to the government's procurement of goods and services.

My name is J. P. Bolduc and I was the Survey's Chief Operating Officer, and I am President of Citizens Against Waste (CAW), a newly established bipartisan foundation organized to educate the public about waste and inefficiency in government. I am also a Senior Vice President of W. R. Grace & Co. With me this morning are Mr. William Tremayne, who is a Senior Vice President with Prudential Insurance, and also served as Project Manager for the Office of the Secretary of Defense Task Force on PPSS; and Mr. John Gish, who is a Group Vice President with W. R. Grace & Co., and also served as Director of Special Projects for PPSS.

Prior to discussing our findings and recommendations on procurement, let me provide a brief overview of PPSS's formation, organization, and conclusions.

On June 30, 1982, President Reagan issued an Executive Order establishing PPSS. J. Peter Grace, Chairman and Chief Executive Officer of W. R. Grace & Co., was named to head the Survey. More than 2,000 private sector volunteers worked on this 18 month study at no cost to the

Federal government. In total the private sector donated \$76 million in people, services, travel and supplies.

The Survey's findings were detailed in 47 individual Task Force reports, which, including a two-volume Summary Report to the President, totalled about 21,000 pages, with an additional 1.5 million pages of supporting documentation.

We made 2,478 recommendations to eliminate waste and inefficiency and enhance government revenues. Assuming full implementation, those 2,478 recommendations would save the government -- and taxpayers -- \$424.4 billion over three years.

Turning to the subject of today's hearing, PPSS recommendations for procurement reform could save an estimated \$34.5 billion over three years. In addition, there are savings of \$37.1 billion over three years possible in the related areas of privatization and contracting-out, and \$11.7 billion in three-year savings possible from eliminating wage-setting laws which increase Federal procurement costs but which are no longer necessary nor

productive. Total savings of \$83.3 billion over three years are possible by reforming the government's method of acquiring goods and services.

Mr. Chairman, you requested that I focus my testimony on ten specific procurement issues which the Subcommittee believes to be most significant.

(Table Follows)

FPSS Three-Year Savings Estimates — Procurement

|                                                                                                                                             | (1)<br>Savings<br>(\$ Millions) | (2)<br>% of Total |
|---------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|-------------------|
| ( 1) Enhance the role of the<br>Office of Federal<br>Procurement Policy                                                                     | NO SAVINGS ESTIMATED            |                   |
| ( 2) Improve the organization of<br>the acquisition function<br>within the DOD                                                              | \$ 1,375                        | 1.7%              |
| ( 3) Centralize the acquisition of<br>"common use" items through<br>the GSA                                                                 | 312                             | 0.4               |
| ( 4) Lessen the impact of socio-<br>economic programs on the<br>acquisition process                                                         | 12,497                          | 15.0              |
| ( 5) Encourage implementation of<br>OMB Circular A-76 on<br>contracting out                                                                 | 7,390                           | 8.9               |
| ( 6) Simplify the regulatory<br>requirements                                                                                                | 644                             | 0.8               |
| ( 7) Enhance competition in<br>contracting through the use<br>of functional or performance<br>specifications                                | 7,423                           | 8.9               |
| ( 8) Improve cost estimates,<br>scheduling, and risk<br>management techniques                                                               | 18,348                          | 22.0              |
| ( 9) Increase stability in the<br>acquisition process through<br>greater use of multiyear<br>contracting                                    | 3,415                           | 4.1               |
| (10) Improve program management by<br>strengthening the role,<br>responsibility, authority, and<br>accountability of the<br>program manager | <u>1,285</u>                    | <u>1.5</u>        |
| (11) Total ten areas above                                                                                                                  | \$52,689                        | 63.3%             |
| (12) Other related issues                                                                                                                   | <u>30,567</u>                   | <u>36.7</u>       |
| (13) Total                                                                                                                                  | <u>\$83,256</u>                 | <u>100.0%</u>     |



I'll briefly discuss each of those issues and the related PPSS recommendations.

Enhancing the Role of the Office of Federal  
Procurement Policy (OFPP)

In 1974, Congress created the Office of Federal Procurement Policy (OFPP) within the Office of Management and Budget (OMB). When OFPP was established, it was intended to have policy making authority in the area of procurement. As it has evolved, however, OFPP has established little authority to implement changes in Federal procurement.

Insufficient action has been taken to incorporate OFPP and procurement reform objectives into the annual OMB budget and program review process. PPSS recommended that OFPP be fully integrated into the OMB budget process in order to strengthen OFPP's procurement policy role.

It should be emphasized that PPSS made no recommendations as to whether OFPP should be merged directly into OMB or maintained as a separate entity. There are arguments for each approach and PPSS recommended further study to determine which organizational alternative would enable the most effective coordination and enforcement of government-wide procurement policy.

In 1982, OFPP submitted a proposal for a Uniform Federal Procurement System (UFPS) to unify both civilian and military procurement policies, streamline the process, increase competition, and clarify responsibility and accountability. PPSS supports the proposed UFPS, with the additional improvement of multiyear contracting.

To achieve the above goals, PPSS recommended:

- o a management structure with clear lines of authority and accountability, a simplified procurement process, and a professional work force;
- o OFPP responsibility to put the new procurement system into operation;
- o legislation to bring Federal procurement practices into line with modern methods and requirements; and
- o OFPP policy authority over all agency procurement, authority to rescind agency regulations that do not conform to policy, and leadership responsibility to develop simplified government-wide regulations.

While Federal Acquisition Regulations (FAR)

have been issued, their impact has been mitigated by the use of agency-specific supplements which effectively nullify the benefits of FAR.

PPSS also concluded that the policy-making role of GSA in this area should be shifted to OFPP so that GSA can concentrate on providing efficient and effective support to other government agencies.

#### Improving the Organization of the Acquisition Function Within DOD

Many acquisition-related problems are rooted in the organizational structure of the Office of the Secretary of Defense. For example, major weapons systems are acquired by separate organizations in each of the three services. Each service maintains personnel to perform the same acquisition management and administrative functions. PPSS recommended that DOD consolidate the acquisition function -- separate from the research and engineering activities in the acquisition process -- under a newly created position of Under Secretary of Defense for Acquisition. This would enhance the ability to eliminate marginal programs, something the services are reluctant to do.

Also, the current DOD organization for contract administration is a combination of centralized and decentralized

activities conducted by the Defense Contract Administration Service (DCAS) and by the individual services. Lack of coordination and variation in operating procedures results in: inconsistency in procedures for evaluating contractor capabilities and performance; inability to reasonably assess operational effectiveness; inconsistency in the quality of the work force; and difficulty in applying innovations across service lines. PPSS recommended that all Department of Defense (DOD) contract administration functions be consolidated under the direction and control of a senior acquisition executive.

Savings from improving the organization of the acquisition function within DOD total \$1.4 billion over three years.

Centralizing the Acquisition of "Common Use" Items  
Through GSA

In FY 1981, total government procurement was \$134.5 billion, of which \$14.9 billion, or 11.1%, were common use items. Of this \$14.9 billion, only \$5.2 billion, or 34.9%, was procured centrally through GSA. PPSS estimated that the government could save \$312 million over three years by increasing the number of civilian agency common use items purchased centrally through GSA and recommended that GSA identify items which could be more efficiently and economically purchased through a centralized procurement process.

Lessening the Impact of Socio-economic Programs  
On The Acquisition Process

Eliminating socio-economic programs which significantly inflate government costs could save \$12.5 billion over three years. There are about 80 such programs which stipulate wage rates; working conditions; assist small, disadvantaged and minority-owned businesses; etc.

PPSS found that:

- Some socio-economic procurement programs may not be achieving their objectives either from a cost-benefit perspective or in an absolute sense.
- There may be a more cost-effective means to implement some socio-economic programs in lieu of the procurement process.
- Some programs which are appropriately implemented via the procurement process may be incurring greater costs than necessary due



to the inefficient way they are administered.

PPSS recommended that a major study of the most pervasive socio-economic programs be undertaken to seek means of reducing their burden on the procurement process without altering their basic objectives.

The most important and costly of these programs are the Davis-Bacon, Service Contract and Walsh-Healey Acts. PPSS recommended repeal of these three acts which would save \$11.7 billion over three years. Our estimates assume full implementation. However, CBO-GAO, which supports our recommendation for repeal, estimated savings of \$3.5 billion over the 1986-1988 period.

Encouraging the Implementation of OMB Circular  
A-76 On Contracting Out

The Federal government performs an estimated 11,000 commercial activities, costing \$20 billion a year and employing a quarter of the 1.9 million civilian Federal workers in the U.S. But just because government provides a good or service, does not mean it should also produce that good or service, especially when the private sector can provide better service at a lower cost. The government could save billions of dollars annually through

"privatization" -- turning government enterprises over to the private sector or contracting with the private sector to perform the service rather than doing it in-house.

In 1983, OMB estimated that adhering to the policies set forth in Circular A-76 could save \$5 billion annually five years after implementation.

PPSS recommended:

- . Enact as law the government's policy of relying upon the private sector for commercial services.
- . Eliminate the various restrictions Congress has imposed on the Executive Branch's ability to carry out that policy.
- . Ensure that cost comparisons are fairly and accurately conducted. As part of this process, OMB should promulgate new and accurate Federal personnel costs, especially with respect to retirement, for use in A-76 comparisons.

Based upon phased implementation, PPSS projects first year savings of \$1.15 billion and cumulative three year savings of \$7.39 billion. When fully implemented (after four years), savings would exceed \$5 billion annually.

#### Simplifying the Regulatory Requirements

Procurement regulations are excessive and, in some cases, inconsistent. A survey of nineteen agencies conducted by OFPP in 1978 and 1979 found 485 offices which regularly issued procurement regulations, and 877 different sets of procurement regulations.

The Commission on Government Procurement noted 30 discrepancies between the two major government procurement statutes: the Armed Services Procurement Act (ASPA) and the Federal Property and Administrative Services Act (FPASA).

PPSS recommended that the government use simpler specifications where warranted.

For example, DOD attempts to cover all aspects of the contracting process, such as how to choose among various types of contracts, how to negotiate prices, reporting requirements, and how contractors are required to set up

their accounting systems and allocate their costs. In an attempt to provide uniformity in the procurement process, DOD has created a chaotic regulatory environment which: increases cost to the government, inhibits the use of professional judgment by contracting personnel, increases costs, and effectively prevents smaller subcontractors from selling to the government, reducing competition. PPSS recommendations are to simplify procurement regulations, upgrade the quality of personnel involved in procurement, and increase competition.

Savings from simplifying regulatory requirements total \$644 million over three years.

Enhancing Competition in Contracting Through the Use of Functional or Performance Specifications

PPSS found that DOD has not adequately addressed the lack of common parts in weapons systems and the excessive use of military specification requirements (rather than normal commercial standards) in contracts.

The problem has been that procurement officials are not sufficiently selective in choosing only the particular military specifications that are truly needed.

PPSS recommended that:

- . DOD carry out military hardware design standardization studies and initiate joint-service development of military hardware and software.
- . DOD consider only MILSPECS related to the item being procured. All other MILSPECS for material, parts, and components included in the end item should be simply reference documents, and not mandatory.
- . DOD use financial incentives to encourage contractors to challenge unimportant or irrelevant "standard" data requirements.

Savings from enhancing competition in contracting through the use of functional or performance specifications total \$7.4 billion over three years.



Improving Cost Estimates, Scheduling, and Risk Management Techniques

PPSS found three primary areas of weapons systems program management where considerable savings could be realized from improved management methods and procedures. These included improved weapons systems planning, improved contracting procedures, and improved cost estimating and scheduling. In addition, PPSS recommended increased use of "dual sourcing."

In the area of systems planning, PPSS recommended that OSD and the services emphasize timely development of comprehensive Program Management and Acquisition Plans at the program level. These improvements include expanding the scope of these plans and maintaining them as working documents, using the plans as the basis for cost and schedule estimates, and delegating authority to contract and manage programs on a decentralized basis. PPSS estimated savings of \$2.940 billion over three years.

In contracting for weapons systems, PPSS found insufficient emphasis on the potential total cost of major weapons programs. PPSS recommended that OSD streamline the source selection process, making it more efficient and effective by selecting contractors based on the lowest total

cost. Potential cost savings are \$980 million over three years.

In the area of cost estimating and scheduling, PPSS recommended that DOD institute more discipline over cost estimates and schedule development to produce accurate cost forecasts, and improve "early warning" indicators of cost overruns and scheduling problems. PPSS also recommended that DOD consider sharing cost overruns with contractors to encourage more realistic program estimates. PPSS estimated that savings of \$2.940 billion could be realized over a three-year period.

One of the best ways to increase competition and reduce costs in purchasing is through dual sourcing.

In defense, there is healthy rivalry during the initial competition for a research and development contract. After this initial competition -- frequently awarded based on a firm's "buy-in" -- the winner becomes the sole developer and producer for the military system over the next 20 years. Thus, a program -- such as a missile system -- may have been acquired originally through competition, but after the first step there is no alternative source for the equipment.

PPSS found that only a small percentage of weapons systems are purchased through dual sourcing, resulting in lost savings opportunities. Dual sourcing could save \$3.4 billion over three years in the Navy and Air Force alone.

Savings from improving cost estimates, scheduling, and risk management techniques total \$18.3 billion over three years.

Increasing Stability in the Acquisition Process Through Greater Use of Multiyear Contracting

Multiyear contracting (MYC) increases stability in the procurement process, which gives contractors opportunities for long-range planning. This results in lower procurement costs due to economies of scale. MYC also encourages contractors to make productivity enhancing investments, increases competition for the initial contract award, and reduces the administrative burden to the contractor and the purchaser. PPSS found, however, that current use of MYC is very limited and that only a few major weapons systems -- the primary opportunity area for MYC cost savings -- have been approved for MYC by Congress. In addition, the Defense Department is currently restricted from entering into MYCs for "commercial items."

PPSS recommended expanded use of multiyear contracting in all Federal agencies. In the area of weapons procurement, PPSS noted 31 programs which met the criteria for MYC with potential savings of \$1.6 billion annually possible upon full implementation of MYC. In addition to weapons systems, PPSS found opportunities for MYC in both defense and civilian agencies in areas such as ADP equipment and photocopying leases, and building maintenance services. Over three years, increased use of MYC could save \$2.958 billion in weapons system procurement and \$457 million in the procurement of non-weapons items in DOD and civilian agencies.

Savings from increasing stability in the acquisition process through greater use of multiyear contracting total \$3.4 billion over three years.

Improving Program Management by Strengthening the Role, Responsibility, Authority, and Accountability of the Program Manager

The Defense Services publish acquisition regulations and guidelines covering program management and the role of the Project Manager (PM). The PM has overall responsibility for the acquisition program. The PM is often provided insufficient support from superiors to adequately

fulfill his duties and the actual scope of the PM's responsibility often does not include all aspects of the program. PPSS recommended that OSD and the Services actively support program managers so that the authority given them matches their responsibility. PPSS further recommended establishing career paths in each program management skill area, increased use of technically trained people in all program management skill areas; and greater use of outside resources, when needed.

Savings from improving program management by strengthening the role, responsibility, authority and accountability of the program manager total \$1.3 billion over three years.

Before concluding, I would like to summarize the current status of PPSS recommendations.

The procedure established by the White House involves representatives of PPSS, OMB, the Offices of Cabinet Affairs and Policy Development, and Agency personnel in a review of each PPSS recommendation. To date, 1,153 of our 2,478 recommendations have been reviewed by the Executive Branch. Almost 82% of the recommendations reviewed have been approved and 680 recommendations with



three year savings of \$103.5 billion have either been implemented or are targeted for near-term implementation. On January 3rd, 1985, the President ordered an updated status report on the 2,478 PPSS recommendations.

Progress has been encouraging but much more remains to be done.

That's why Citizens Against Waste (CAW) was formed last year -- to educate the public as to the seriousness of the government's financial condition and to gain their support for eliminating wasteful and inefficient spending primarily through the adoption of PPSS recommendations. Our Board of Directors is indicative of the bipartisan support for which we are striving. It includes William Simon and George McGovern; William Proxmire and Claude Pepper. We've already produced 750,000 brochures, delivered hundreds of speeches nationwide, developed a five-part television series that's been seen by 15 million people, published 2 books, distributed more than 1.5 million pieces of literature since September 1984, appeared on dozens of television shows, and provided more than 500 interviews to magazines and newspapers.

And we're going to do more -- much, much more. The U.S. Chamber of Commerce is supporting us in their newsletter, television program and local chapters. The Advertising Council has approved \$50 million in pro bono advertising. We're mounting the largest and most broadly based education campaign that's ever been undertaken in this country.

I emphasize the scope of our undertaking simply to indicate to you how hard we're willing to work to help you reduce Federal spending.

I appreciate the time and attention the Subcommittee has given to the review of PPSS recommendations. The interest shown by you and your colleagues gives us hope that the opportunities offered by PPSS will be fully explored and implemented.

Although PPSS was established by Executive Order, 73 percent of our recommendations will require legislative action for implementation. In addition, much of the remaining 27 percent will be heavily dependent on Congressional support if projected savings are to be achieved. I and my associates have provided testimony in more than 30 Congressional hearings and briefings. We are

ready to provide whatever assistance we can to the Executive and Legislative branches to further the understanding, acceptance, and implementation of PPSS recommendations.

Now that I have provided the Committee an overview of savings opportunities available in the general area of government procurement, I would like to ask Bill Tremayne to discuss one of these improvement opportunities in greater detail so that you might better appreciate what can be accomplished if we work together for a more efficient government and a better America for all. Mr. Tremayne will discuss how the organization of the acquisition function within the Department of Defense can be improved.

Testimony of Mr. William H. Tremayne  
Before the Senate Subcommittee on  
Oversight of Government Management  
January 23, 1985  
Dirksen Senate Office Building - Room SD - 326

My name is William H. Tremayne and I was Project Manager of the Office of the Secretary of Defense Task Force of the President's Private Sector Survey on Cost Control. I am also a Senior Vice President of the Prudential Insurance Company of America. Members of the Executive Committee of PPSSCC who provided guidance to our review were Carl Covitz, President of Landmark Industries; Carter Burgess, Chairman of the Executive Committee of the Foreign Policy Association and former Assistant Secretary of Defense; James E. Burke, Chairman and Chief Executive Officer of Johnson & Johnson; and Robert A. Beck, Chairman and Chief Executive Officer of The Prudential.

We had the benefit of a meeting with you, Mr. Chairman, prior to commencing our review and the insights you provided were extremely helpful to us in lending focus to what then seemed an enormously broad charge of discovering major cost saving opportunities in the Department of Defense.

Mr. Bolduc has already discussed a number of the recommendations that were made by the OSD Task Force. I believe that they have great potential to simplify the procurement process while saving

many billions of dollars annually, a worthy objective at any time, but especially now as you wrestle with the challenge of reducing federal budget deficits.

This morning I would like to elaborate on a key recommendation mentioned by Mr. Bolduc. This is issue OSD-15 in the Report of the OSD Task Force (pages 134 to 145) entitled Improved Organization of the Acquisition Function.

We recommend that the DOD should consolidate the acquisition function - separate from the research and engineering function - under a newly created position of Under Secretary of Defense for Acquisition, thus providing more professional attention to the procurement and production phases of the acquisition process.

We believe that this change would bring much-needed discipline to the acquisition process within DOD. It would require that designs be completed and accepted before major procurement and production begins, rather than tolerating endless tinkering.

An even more far-reaching recommendation - yet one we feel is completely warranted - is the total consolidation of the acquisition function at the OSD level. Under this proposal all research and engineering functions would be consolidated by the Under Secretary of Defense for Research and Engineering. The procurement and production functions would be consolidated by the Under Secretary of Defense for Acquisition.

The present research and engineering functions would be removed from the services. Under this proposal the services would determine mission needs, conceptualize countermeasures, develop mission element needs statements, and charge the acquisition agency with development and production of weapons systems to meet these needs at a minimum cost on an agreed schedule. The services would retain the functions of test and evaluation and acceptance of the final system.

Adoption of these proposals would yield significant efficiency and cost reduction benefits. It would lead to significant alleviation of program instability and the excessive number of new starts that we currently experience.

I was gratified to learn last year that Senator Roth, Chairman of your full Committee on Governmental Affairs, had reached the same conclusions that we had. While his suggestions were predicated on a GAO study released more than a year after our review, his specifics square precisely with those that we have related.

Citing similar problems as to cost estimating and reporting, Senator Roth said, "the best way to curb cost growth and improve the management of major weapons programs would be to turn the procurement of major new weapons over to a centralized agency in



the Pentagon staffed by civilian procurement professionals." Senator Roth said that he was "becoming convinced that we will not be able to change attitudes and ensure cost effective management unless we make fundamental changes in our acquisition system."

Gentlemen, I hope that a full reading of our report on this issue and thoughtful consideration of its consequences will be convincing to you as well. My latest understanding was that Senator Roth would probably be urging action on his proposal during this session. I hope you will be supportive of this consolidation proposal as well as our further proposal to separate the acquisition function from the research and engineering function.

I will be pleased to answer any questions you might have.

Senator COHEN. We're going to hear now from a panel of administration witnesses: Joseph Wright, the Deputy Director of the Office of Management and Budget. He's accompanied by Mr. William Mathis, the Acting Administrator of the Office of the Federal Procurement Policy. Mary Ann Gilleece will testify for the Department of Defense. And Allan Beres will present the position of the General Services Administration.

Mr. Wright, why don't you proceed first?

**TESTIMONY OF JOSEPH R. WRIGHT, JR., DEPUTY DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY WILLIAM E. MATHIS, ACTING ADMINISTRATOR, OFFICE OF FEDERAL PROCUREMENT POLICY; MARY ANN GILLEECE, DEPUTY UNDER SECRETARY OF DEFENSE (ACQUISITION MANAGEMENT), DEPARTMENT OF DEFENSE; AND ALLAN W. BERES, ASSISTANT ADMINISTRATOR, OFFICE OF ACQUISITION POLICY, GENERAL SERVICES ADMINISTRATION**

Mr. WRIGHT. The seat is warm. You've had him here for a while. [Laughter.]

I don't know whether you're aware, Mr. Chairman, but Mr. Bolduc and I used to work together at the Department of Agriculture. He just came up to me and said, if you need some help, let me know. [Laughter.]

You think he'd get over that after 15 years. [Laughter.]

Mr. Chairman, I'm delighted to be here. I have with me Mr. Mathis, who is the Acting Administrator of the Office of Federal Procurement Policy, who also would be more than happy to answer whatever questions you may have.

I have a very short—you'll be happy to see—statement that I will just submit for the record, with your permission, and just simply say that, for the most part, you asked OMB to review six of the recommendations. While we do have a few problems with some

of them, as you would expect, for the most part, we agree with all six.

You can go through my testimony, as I'm sure you already have. I will just simply state, make one comment, and that is that I'm astounded to see a little bit that, as yourself has expressed a concern, and Senator Chiles, that we are proposing to abolish the Office of Federal Procurement Policy.

Senator COHEN. I don't think I said that. I think "merge" is the word that I used.

Mr. WRIGHT. Well, there's a big difference between the two. And I believe the word "abolish," perhaps, that Senator Chiles mentioned came from a newspaper article, which sometimes is not, as you know, always the most accurate in expressing the intentions of either the executive or the legislative branch.

We have no intention of abolishing OFPP, nor do we have any intention of trying to do it through an executive move. This was established, as Mr. Bolduc said, by the Congress and we are proposing strengthening the Office of Federal Procurement Policy by merging with the management side of OMB, where it can play what we think is a much more important role, as it has during the past year.

And the reason I am up here today, even though I have to say that you did invite Mr. Mathis, is that I felt it was important to be able to have this discussion with you prior to the legislative proposal coming up.

Senator COHEN. Is Mr. Mathis here?

Mr. WRIGHT. Yes.

Senator COHEN. I saw an empty chair. That was not symbolically intended. Why don't you come forward.

Mr. WRIGHT. But, anyway, I felt it was important that we go ahead and have the discussion in the form of testimony. So that's why I'm here. And I'm delighted to be here.

Thank you, Mr. Chairman. I'll answer whatever questions you like.

Senator COHEN. Well, Mr. Wright, why don't you just proceed to say why you disagree with every former administrator of the OFPP? They've drafted a letter to the President. I'd like to read it to you. You may have seen it, in which they strongly oppose the proposed merger. And I'm going to quote now:

We cannot conscientiously stand by in silence and let this institution be effectively destroyed. The absence of a vocal, independent voice to coordinate and develop sound government-wide procurement policies will certainly spell disaster for the reform mechanisms now in place. Leaving the agency to take individual, uncoordinated approaches to procurement policies affecting the private sector is a guaranteed formula for failure of many procurement reforms.

Now this was signed by all of the prior administrators. Why are they wrong and you right?

No play on words intended, but you're right in seeing the merger as strengthening the OFPP. [Laughter.]

Mr. WRIGHT. Mr. Chairman, it's too early in the morning for that.

Senator COHEN. It really is. [Laughter.]

Mr. WRIGHT. It really is.

Senator COHEN. I apologize for that. [Laughter.]

Mr. WRIGHT. Well, first of all, it wouldn't surprise me to see the former administrators react in this fashion to merging it within the Office of Management and Budget. I would say that if you would have one of them come in and say that that would be a good idea, after they held that position, seeing as how their individual position that they held at one time is not going to be there, that's normal. I would respect that.

Senator COHEN. Let me answer that. I disagree with that. I would think that they have nothing—there's no axe to grind on their part. They're now out. I can see an administrator coming in and saying, hey, I think it would be a terrible mistake, what you're doing. I want to preserve my position. But now that they're gone, I would think that there would be less incentive for them to come forward with as strong a statement as they have. It's more or less like various people in the military leaving the military, maybe even JCS and the Joint Chiefs of Staff, and suddenly coming out and saying, we've got to reform that system. It's terrible the way it operates now.

They always have to wait until they get out before they make the recommendation as to what has to be done. And it seems to me the same sort of mindset is there as well. When you leave, you have some very good ideas as to what has to be done and you have nothing to protect other than what you think is in the best interests of the country.

So why is that different in this situation? They're not holding on to anything. They get nothing. They get no compensation for coming out with a position like that.

Mr. WRIGHT. I would say, Mr. Chairman, No. 1, the procurement community is a community unto itself, with all due respect to my friends over here at the table. [Laughter.]

Senator COHEN. I don't disagree with that.

Mr. WRIGHT. They like working with each other or against each other, whatever it may be. This is a part of the Federal Government that is, like I said, a highly professional group of technicians that like their institutions, for the most part, kept the way they are.

Now, that's one part of it.

The other part of it, as Senator Chiles mentioned, is there has not been what we would call the "M" in OMB. And I would say that you will find, as we submit our first management report as part of the budget this year, that that is no longer true.

The management side of OMB has been substantially strengthened and is a part of the budget process. And what we're looking to do is, as Mr. Bolduc said, also make sure that procurement is an important part of the management program and is an important part of the budget process.

I believe if you do not do that, you simply make it a regulatory arm that does not have the teeth of the budget process, which, Mr. Chairman, is the way we really communicate, not only between agencies, but between the executive branch and the legislative branch. And that's what we're trying to do.

Senator COHEN. In 1983, when you came before the committee and testified in favor of reauthorizing OFPP, I didn't hear a single word mentioned about merging it into OMB. What I want to know

is what happened between 1983 and 1985 other than Ronald Reagan's reelection?

Mr. WRIGHT. We did not have the management process in place and operating as part of the budget process within the Office of Management and Budget at that time. We now have it. It is in place. It is well documented. It is effective. And I think, as the Grace Commission recommended, we did take a good, hard look at the role of OFPP and made a determination that the best way to make sure that procurement is highlighted, is important, and has teeth is to make it an integral part of OMB.

Senator COHEN. But when you testified last year or the year before, about giving OFPP regulatory power to enforce the regulations, OMB was opposed to it.

Mr. WRIGHT. At the time, we did not feel that it needed regulatory power. But also, there's an important step that has happened since the time I came up and testified in 1983. And that is we now have the management program in place as part of the budget process, and you will see that in our first management report coming up in February.

Senator COHEN. Under this plan, would you see the need of a Presidentially appointed and Senate-confirmed OFPP Administrator?

Mr. WRIGHT. No, sir, I do not. As a matter of fact, I would go the other way. I would say that if you are going to make OFPP an integral part of the management process at OMB, to have a Presidentially appointed and Senate-confirmed Administrator would not make this person feel a part of the OMB team. The rest of OMB, the division heads and Associate Directors, are not in that category.

Senator CHILES. Who's going to head up this management team?

Mr. WRIGHT. Arlene Triplett, who is the Associate Director for Management, with the Office of Management and Budget, has been doing this for the past year and has taken the responsibility for overseeing our entire management review process as part of the fiscal 1986 budget. She is already in place.

Senator COHEN. Assuming that Congress doesn't approve of the merger, do you have anybody in mind who is going to be the Administrator of the OFPP?

Mr. WRIGHT. Mr. Chairman, that's something that we can talk about. I'd be happy to now. I think it's important to mention also that what we'll be proposing is not taking OFPP and dismantling it and spreading it through OMB. What we're talking about doing is taking it as a unit, putting it within the management side of OMB, as an important unit, and making it an integral part of the management reviews and the budget process.

Senator COHEN. Do you agree, Mr. Wright, with Ms. Gilleece's submitted statement about the Grace Commission's estimates being "grossly overstated?"

Mr. WRIGHT. I think that the answers that were given by Mr. Bolduc, I would put them a little shorter, more briefly, but I think they were reasonably accurate. They were estimates.

At the Office of Management and Budget, we have been asked to verify those numbers. We look upon them as goals which you should have. You ought to put some type of numerical goals, esti-



mates, whatever you want to call it, on any recommendations, and that's the way we look upon them.

Senator COHEN. But I can put \$1 billion down.

Mr. WRIGHT. Yes; you can.

Senator COHEN. Or I can put a half million. Doesn't it make a difference in terms of your judgment as to whether they are reasonable estimates or they are grossly exaggerated? I mean, you do draw such a distinction.

Mr. WRIGHT. I do draw such a distinction, but I'm also representing the Office of Management and Budget, and we take a look at what can be put in the budget and proposed to the Congress.

Senator COHEN. Do you believe the Grace Commission's recommendations are reasonably achievable?

Mr. WRIGHT. I believe that the recommendations are reasonably achievable for the most part. I believe that the numbers, if you were to take a look at them within a 3-year period of time, and I reemphasize, a 3-year period of time, as is being looked upon by many members of the press, are not achievable. But I do not believe that the Grace Commission has ever said that they would be achievable within a 3-year period of time.

Senator COHEN. Do you think raising the threshold for the application of the socioeconomic programs to, say, \$25,000, would enable more small businesses to compete for Federal contracts?

Mr. WRIGHT. I think it could. I do not have a specific answer to that. We would like to propose a test through the OFPP on taking a good, hard look at that, and we are now in the process of preparing that proposal.

As you know, the testing authority that was given to OFPP last year requires that we come up and propose these tests to the Congress. And so we would like to work with you on seeing whether or not raising the threshold, No. 1, makes sense as a test and, No. 2, to see whether or not it's a good thing to do.

I think that it would result in a much more simplified procurement process, but I need a little more time to really determine whether or not we would make that proposal.

Senator COHEN. Back in 1972, the Commission on Government Procurement reported that the proliferation of procurement regulations was a pervasive problem. And some 10 years later, the Grace Commission came up with exactly the same analysis and said that the Defense Department had created a "chaotic regulatory environment."

Since the Commission's report, the administration apparently has sought to take care of this by establishing a single system of Governmentwide regulations called the FAR, the Federal Acquisition Regulation, which became effective last April. The FAR is supposed to consolidate all of the existing regulations into one Governmentwide system, with only those supplemental regulations essential to meet agency unique needs permitted to be issued by the individual agencies.

Are you familiar with what's happened since the FAR went into effect?

Mr. WRIGHT. Reasonably familiar, yes, sir.

Senator COHEN. Maybe I could just point to it. This is the FAR, OK? Those are the Defense Department supplements to the FAR.

In effect, the one document that is supposed to introduce conformity and, uniformity among the procurement regulations has been totally outweighed by all the supplements.

How effective are the FAR's? What's been done to curb the proliferation of regulations since the FAR was adopted?

Mr. WRIGHT. First of all, they started with about 6,000-plus pages of what I would call primary regulations. They cut that down to 3,000-plus pages.

Second, regarding the pages of secondary regulations, they started with about 60,000 pages or something like that, and plan to cut them down to 32,000 or 33,000 pages.

As Bill Mathis can attest, or Don Sowle, who was the Administrator at the time, one of the questions that I continually had—why do we need that many?

A very good answer was provided—let's make the first reduction, the first simplification, and then continue the process.

OFPP policy letter 80-5 that came out in 1980 gives OFPP the responsibility for oversight of the regulations. They've been going through and establishing agency standards on implementing the FAR since it became effective April 1 of last year.

Senator COHEN. Who's responsible for that? Who is responsible for reviewing the agency's supplement to the FAR?

Mr. WRIGHT. OFPP. And will continue to be. Now, I look upon that as a continual process. Pardon me, Mr. Chairman. First of all, you have the agencies themselves review their secondary regulations. Then all regulations are submitted, or regulatory changes, are submitted to OFPP for review.

So I think what you're asking, who has the responsibility for overall policy review, it's OFPP.

Now, beyond that, I would say that it's a continual process. And as a result of the Competition in Contracting Act that was passed last year, which gave OFPP additional authority, we are in the process of coming up with a revised policy letter 80-5. And we'll be submitting that.

Senator COHEN. Do you agree with Mr. Bolduc's conclusion that what has taken place with the addition of the supplements has totally undermined the effectiveness of the FAR, itself?

Mr. WRIGHT. Totally undermined? No, sir, I do not agree with that.

Senator COHEN. Rendered it ineffective, I believe was the Grace Commission's analysis.

Mr. WRIGHT. No; not ineffective. I don't agree with that. I believe that the entire FAR process was a good process. It was a first stage of simplification and reduction in complexity. There are more stages to go through, obviously.

Senator COHEN. What I'm getting at is, the supplements far outweigh the FAR itself.

Again, it's too early in the morning for that, but— [Laughter.]

I mean, how do we deal with this problem? We're supposed to be simplifying, making it more uniform, and what we've got is each agency coming in with their own supplements. And that takes us right back to 1972 when the Commission on Government Procurement found there to be a massive proliferation of regulations with each agency claiming that they've got unique needs.



Mr. WRIGHT. I totally agree with Mr. Bolduc. I think it's gone too far. I think it can be simplified further and cut down. You have got to remember, every single time that you try and take that on, you do have these appeals from the agencies on their unique needs. I think that OFPP has taken a reasonably smart approach toward making what progress it can. It will have to keep working at it.

I'm not saying that as a bureaucrat; I'm saying that the screams come in all the time from these agencies about their uniqueness and that OMB and OFPP are running roughshod over them.

I believe there has been progress made. I believe there's a long way to go.

Senator COHEN. Do you believe that there's a difference between inconsistent supplementation and unnecessary supplementation?

Mr. WRIGHT. Yes, sir, I sure do.

Senator COHEN. Don Sowle, as a matter of fact, put out a memorandum to Mr. Stockman in which he states that instances of unnecessarily duplicative regulations have already been found in the Department of Health and Human Services and in the Defense Department.

Is the OFPP going to be charged wherever it may reside—as a separate organization or within OMB—with the responsibility for eliminating unnecessary regulations?

Mr. WRIGHT. Well, first of all, Mr. Chairman, I totally agree with what Director Stockman says. [Laughter.]

It's called good career planning early in the morning. [Laughter.]

Senator COHEN. Well, at least it gives a uniformity to your testimony.

Mr. WRIGHT. Yes. [Laughter.]

The second point is that, yes, OFPP will have that responsibility. The difference is, and that is if we can persuade the Congress on the legislative requirement in order to make OFPP a part of OMB on the management side, is not only will they just do it through the regulatory process; they will also do it through the management and budget processes.

And I would not discount what we call pretty important teeth in this town.

Senator COHEN. Senator Chiles?

Senator CHILES. Well, given the fact, Mr. Chairman, that that was about a 12-year process that we went through to get to the first cut of the FAR, I don't know that we can say that we're making tremendous progress.

Mr. Bolduc made the point this morning that the management function in OMB goes beyond procurement. I certainly agree with that.

I'd like to point out that from an historical perspective, with the possible exception of the financial management components, all of the management components of OMB were originally created in response to initiative from either this committee or the Committee on Government Operations in the House.

It seems like to me that sort of shows that there are a number of us that want to see the "M" in OMB. With that kind of being true, it would seem like to me that you would include the Congress some in your deliberations of what you're talking about doing in management. That might be wise to do. Rather than just sort of bring

us something and say, here, this is now how we're going to invent the wheel.

Mr. WRIGHT. Senator, you have just spoken music to my ears. While you were out of the room, I mentioned to the chairman that we will be submitting our first management report in February as part of the fiscal 1986 budget. We will lay out exactly what has been accomplished and what our goals are over the next several years.

We will lay out exactly the results of the management reviews. We have started the management review process as part of the budget process. And I think that you would be pleased to see that progress has been made in the past couple of years.

I would very much be interested, as coming from one of the Senators who has been interested in this whole area of management improvement in the Government, to get your comments after you have a chance to review it in February.

Senator CHILES. Well, given the fact that I can't recall a major decision that the Administrator of OFPP has taken that was at variance with the views of the Deputy Director or Director of OMB, it would seem to me putting clout in that office is the way to go rather than saying that we're just going to merge it.

Mr. WRIGHT. It's not simply saying that we want to merge them. I totally agree. Putting clout in the office is important. But within the Office of Management and Budget, part of that effort to put clout into the OFPP is not separating it off as if you want to call it, making a totally separate organization that we're just administratively responsible for. It is making it part of our management reviews and our budget process.

We did not have those management reviews fully up to speed, operating well, and in a position to be able to report to the Congress until this year.

The Grace Commission did recommend that we take a look at making it part of the management review budget process. We did take a look at it, decided the time is now, and we are proposing this to the Congress.

Senator CHILES. That's all.

Senator COHEN. Ms. Gilleece, would you want to make a statement?

Ms. GILLEECE. Yes, sir. First, Mr. Chairman, let me thank you very much for inviting the Department of Defense to provide views on this very important matter today. But let me also thank you and certainly Senator Chiles and Senator Levin for your honest concern about helping us improve the procurement process.

The Grace Commission report addresses many issues, eight of which you've asked me to discuss today. Let me state unequivocally that we support the Grace Commission's report as far as what it attempted to do, which was analyze improvements that could be made in Government.

We, as you know, have many internal audits that we do ourselves where we self-examine our functions. But this was one of the few times that we have had our counterparts from the private sector take a substantial amount of their time and focus on our system with a view toward improvement.

Senator COHEN. Could I stop you there, Ms. Gilleece?

Ms. GILLEECE. Yes, sir.

Senator COHEN. It seems to me that everybody wants to kill this report with kindness. There hasn't been a single voice raised in opposition to the Grace Commission report, including those sitting up here behind this podium. And yet, I saw a National Journal article, which referred to an internal critique of the Commission's report by the Office of the Secretary of Defense. This critique apparently shows that the Defense officials attach little credibility to many of the Commission's recommendations, by stating that the Commission members "took on more than they were qualified to do when they recommended sweeping changes in the Defense Department's organization."

So, on the one hand, everybody praises it, and, on the other hand, they say they don't know what they're talking about.

Ms. GILLEECE. Mr. Chairman, if I might respond to that comment.

As I stated in my prepared remarks, we do support the recommendations. However, we have serious reservation about the savings figures attached thereto. The one that you mentioned just now, reorganization of the acquisition function, within the Department, is one recommendation that we do not support.

Senator COHEN. But according to the Department's internal critique, the timing and magnitude of the cost savings are very unrealistic.

Ms. GILLEECE. That's accurate, sir. That is our position and we've been very vocal about that.

Senator COHEN. So that, on the one hand, they're very unrealistic on the costs and, on the reorganization side of things, they don't understand what they're doing.

Ms. GILLEECE. For example, one of the recommendations that you asked me to discuss today was the recommendation on multi-year contracting. The multiyear concept was certainly well accepted by Congress when it came over as a legislative initiative. It has been supported, I think appropriately, by Congress since then.

We have seen 30 programs approved since the passage of the legislation, and we have achieved significant savings. In fact, \$4.5 billion.

That is one of the recommendations of the Grace Commission to which they attach future savings figures. We can go back and look at the dollar figures that we have saved in the past. We cannot, however, project out into the future what the dollar savings will be. We have a difficulty with that because I can't honestly tell you what multiyear programs we will suggest to you should be approved by Congress 2 or 3 years from now.

Senator COHEN. But how do you know they're unrealistic, then? How can you say that they're unrealistic if you don't know?

Ms. GILLEECE. Your point is well taken, sir. The only thing I can suggest to you is that we cannot support the dollar figures attached.

Senator COHEN. Simply because you don't know what programs are going to be adopted in the future.

Ms. GILLEECE. We certainly hope that we will be able to come back to you with savings greater than the \$4.5 billion over the same amount of time.

Senator COHEN. So why don't you continue with your statement.

Ms. GILLECE. As I just indicated, we do support seven of the eight recommendations. The one that we did not support was the reorganization. Of course, you spent some time discussing that this morning. And as was quoted, we essentially do not believe you can reorganize your way out of problems. We do not agree that this should be done as a total reorganization within DOD because, quite frankly, we believe that it will cost a substantial amount of money, with not necessarily any attendant benefits to such a reorganization.

Senator COHEN. Why would it cost you more money to reorganize? What are the cost factors involved that you don't believe the Grace Commission took into account in making its analysis?

Ms. GILLECE. Well, sir, they attached no money whatsoever as far as the savings are concerned to this particular recommendation. We are suggesting that that's probably accurate. There would be no savings. But we're also suggesting that it would cost a great deal of money to reorganize.

Senator COHEN. Why is that?

Ms. GILLECE. Well, simply, the administrative burden of changing offices, of putting different people in different places—the simple administrative burden of reorganizing an office always costs a great deal of money.

Senator COHEN. But that's done all the time. You're always switching boxes around. I mean, if, in fact, it would streamline the procurement process and if, in fact, it would make it more efficient, just because it's going to cost some money to move different people into different office space, that shouldn't be an impediment if, in fact, the ultimate idea is good.

Ms. GILLECE. I did not mean to lead the chairman to believe that that's the only reason we did not agree with that particular recommendation.

Senator COHEN. Tell me the rest.

Ms. GILLECE. We do not believe that sweeping reorganization is necessary within the Department of Defense. However, we still are examining that particular recommendation. I know it is currently under consideration within the Department. But the massive reorganization that was suggested—for example, having a single civilian buying activity, I don't think is a realistic recommendation.

Let me mention, if I might, that the Department of Defense, through its Defense Acquisition Improvement Program, has already put into effect some of the recommendations of the Grace Commission.

For example, tailoring the specifications in a particular contract to meet the specific need, Carlucci Initiative No. 14 was specifically directed at that particular point. And as recently as last December, the Deputy Secretary signed an additional memorandum to the services directed at institutionalizing this procedure in our major systems acquisitions.

He also required that the services appoint a flag-rank advocate to be responsible for this particular program.

Senator COHEN. When did that go into effect?

Ms. GILLECE. That particular initiative was Carlucci Initiative No. 14.



Senator COHEN. Right.

Ms. GILLEECE. Which was initially developed in the beginning of this administration.

Senator COHEN. Right.

Ms. GILLEECE. And there have been directives signed out since then, the most recent being last month. Each one is a follow-on to the previous one, as we gain knowledge about how this particular initiative should be implemented.

Let me mention, Mr. Chairman, that in 1980, the Congressional Budget Office found that our cost growth within the Department was approximately 14 percent.

Largely, the initiatives of the Department, they found that our cost growth for 1983 was less than 1 percent.

So I believe that we have some good news to tell you. The importance that we have attached to the initiatives—many of which are very similar to the recommendations of the Grace Commission—has resulted in significant savings for the Department.

We have already discussed our position as far as the savings analysis by the Grace Commission. I will again state to you that we certainly are supportive of what the Grace Commission is attempting to do. It is not rhetoric. We are doing a full and thorough examination of each of the recommendations. We support them, and we will continue to implement them where appropriate.

Thank you very much for providing us the opportunity to discuss them.

Senator COHEN. Thank you very much for your testimony. I might point out that while we tend to focus much of our criticism upon the Department of Defense, there have been a number of improvements made to the defense procurement process during the past few years. For example, they are moving more toward multiyear procurement. They are seeking—particularly, I might add, in the Navy, through Secretary Lehman—to use more dual sourcing. I know from personal experience a number of major weapons systems in which the cost has plummeted dramatically simply by virtue of having another competing contractor in the process.

And we have to do more of it. There also has to be a recognition of the fact that it costs more money up front to have more competition. Ultimately, the savings are going to be substantial. But initially, to have dual contracting on every major weapons system, with some exceptions, is going to cost the Federal Government, the taxpayer, more money and not less.

But I do think that DOD has made some significant strides in trying to reform its procurement practices. Anyone who has tried to study procurement usually comes away with a profound sense of frustration and disappointment because it is so massive and so complex.

For those who are impatient and look for quick solutions, there aren't any. And I think in this regard, the Grace Commission's recommendations tend to dovetail into those who have studied the matter for years—Jacques Gansler is one, and Norm Augustine another, both of whom will be testifying later. They see similar problems.

The Grace Commission, for example, has found a problem resulting from the consolidation of the responsibilities for research and

development, engineering, procurement and production, all under one office. Their conclusion is that it leads to gold-plating and that there ought to be a separation of the functions—someone concerned with research and development and somebody else concerned with the procurement and production.

Now the CSIS—that's the Georgetown study group—and Jacques Gansler and Norman Augustine are both members of that group, make a similar analysis as to the nature of the problem, but come up with a different recommendation. They don't think the Grace Commission's recommendation is necessarily the correct one.

But they also agree that there is a fundamental problem in how we're going about doing our business. They find a policy vacuum—if I can put it most succinctly. In fact, I was going to quote what the CSIS study says: "OSD has failed to provide an overall framework and set of guidelines in which service acquisition decisions can be supervised and coordinated. Military services thus develop weapons independently, each according to its sense of national security priorities. And, as a consequence, many weapons seem to be matched poorly to fundamental national strategic objectives."

So there's a whole range of professional opinion as to the nature of the problems we are confronting. But they differ in terms of what the solution should be. Maybe they're not right, either. We're going to hear from them as to why they have a better recommendation than perhaps the Grace Commission.

But it does at least raise to mind, and I'm sure you come into contact with, as do I, the problem of the \$400 hammer or the wrench or the coffee pot. Those are very, very visible symbols to people. They may not be able to understand why it costs \$600 million to build a 688 class submarine or \$1 billion for a Trident. But they do understand the amount of waste that's involved by procurement practices.

And frankly, I'll tell you again and again, I think some of our major contractors are engaged in a deliberate policy of extracting as much money as possible, unreasonably so, out of our taxpayers for systems. It's unnecessary. I think at times it borders on the fraudulent. And we've got to change the system in order to sustain public support.

So, I know that you're concerned about it. I know that you've been working in this field. Everybody wants to do something about this problem. Nobody that I know of is a member of Citizens for Waste. You know, there are Citizens Against Waste. I don't know anybody who is for it. The problem is how do we deal with this overall monster of a Federal Government that we have. So, I will call other witnesses to perhaps expand upon their particular solution. But I would ask you, Ms. Gilleece, in your own professional experience, to what do you ascribe the gold-plating problem that we have?

Ms. GILLEECE. Mr. Chairman, there are a couple of examples of what I guess you would call gold-plating. I have certainly been cognizant of the coffee pot and a few of the others. And I don't think that there is a simple solution.

I have seen overspecification myself. There was one particular item that has been discussed in the newspapers quite extensively. I saw the 30-some-odd drawings required to make the particular



item. These should have probably only been two or three. I'm not an engineer, but I've been told that by engineers.

I think that the particular directive that I referenced, the Initiative No. 14, which will require the tailoring of specifications, will, in the final analysis, do a great deal toward resolving that problem.

I don't think you're going to change that today. But, I think that you should also know that the Deputy Secretary did sign a memo the end of last year to each of the service secretaries asking them to go into their already-existing equipment to look and to determine if there are any items which have been overspecified and take a look at how they should be changed and if, in fact, they should be bought.

I think the initiatives that we have ongoing will—perhaps not next year, or the following year—but in the long run will resolve the problem.

Senator COHEN. Do you see any merit trying to separate out research and development from procurement and production?

Ms. GILLEECE. Mr. Chairman, I sit as a permanent member of the Defense Systems Acquisition Review Council [DSARC]. I also am responsible for part of book 1, and all of book 8, in the program review process, the budget review.

Our voice is heard within the Department. We are a supporting function to the Secretary of Defense. We are to advise him as to the best business way to purchase items. And we do so through the Under Secretary for Research and Engineering, as to the best business way to purchase items.

I certainly have a great deal of opportunity to provide to him our thoughts on those matters.

Senator COHEN. Let's turn to the FAR, as I mentioned before. My understanding is not only did the Department of Defense issue a supplement to the FAR, but each of the services has also issued a supplement to the DOD supplement, and each of the commands has issued supplements to the service supplements.

Where do we stop that process of issuing supplements to the supplements to the FAR? And why is it so—I don't understand. Why is each service procurement so unique? I know that they have to have unique weapons systems. But why does their procurement processes themselves have to be so unique?

Ms. GILLEECE. Mr. Chairman, as Mr. Wright said, this was our Federal acquisition regulations system beginning. Those books essentially implement 4,000 laws, as well as provide to our 50,000 contracting people within DOD procurement or to how they will, in fact, work those 15 million contract actions a year.

So let's look at the massive size of the undertaking that they are supposed to regulate.

Now having said that, we are responsible for almost 85 percent of the money that is spent in the Federal procurement budget. When we looked at the writing of the FAR, we saw no reason that some of the other agencies that do not buy major weapons systems, should have in their particular offices the necessary regulations that we need for buying major weapons systems. This is why, essentially, you have a DOD FAR supplement.

And I'm sure that you also are aware that the services do buy things differently because their missions are different. And I think we have to accept that. The Navy buys a ship—

Senator COHEN. Does that necessarily follow? Does it follow because they have different missions they have to buy differently?

Ms. GILLEECE. Mr. Chairman, the Navy does buy differently than the Air Force and the Army.

Senator COHEN. Why?

Ms. GILLEECE. Because their mission—the types of things they buy are different. For example, as I know you're aware, Bath Iron Works did a very fine job.

Senator COHEN. Or General Electric.

Ms. GILLEECE. I understand that. Essentially, you have an entire city on one ship. You don't have that kind of thing in an airplane. An airplane takes off and lands within a period of time. You have people living on that ship. So you have many more things that you have to buy and many more things to take into consideration when you're buying a ship than when you're buying an airplane.

Senator COHEN. But does the process of buying have to be unique or different just because they have different pieces of equipment and a different mission?

Can't you have a more uniform system of purchase and procurement, even though you have a different mission? Do they necessarily have to be separate and distinct?

Ms. GILLEECE. In those cases where they can be uniform, the procedures are on the DOD supplement. We have invited anyone to look at the supplements and if they believe that there are things that should be deleted or altered or incorporated into the FAR, to please provide us that information.

Mr. WRIGHT. Mr. Chairman, if I may add one thing. The Department of Defense and the administration has been trying to convert to functional specifications now for years. The last two appropriations bills for the Department of Defense have prohibited them from making the conversion from technical to functional specifications, which would alleviate much of the problem.

Now, I understand that DOD has about 40,000 technical specifications and it has been able to convert 1,000 to functional specifications. It would help enormously if we could get your support, Senator, as the DOD appropriations bills come up to take that rider off of that legislation. You would make a substantial savings and, I believe, simplify the procurement process.

Senator COHEN. It's my understanding that the overwhelming majority of contract actions within the Defense Department, something approaching 95 percent, are for small purchases.

Ms. GILLEECE. I believe that your statistics are a little high, if I might suggest. I think they're around 75 percent.<sup>1</sup>

Senator COHEN. A little overestimated, like the Grace Commission. [Laughter.]

Ms. GILLEECE. You know, I hate pulling figures off the top of my head, but I think I've used around 75 percent as the figure. Yes,

<sup>1</sup> According to the Federal Procurement Data Center, 98.4 percent of the 14,763,361 contract actions within the Defense Department for fiscal 1983 were small purchases under \$25,000.

sir, most of our procurement actions are small purchases and with small businesses.

Senator COHEN. Just a final point. You indicate in your written statement that the Department agrees with the Grace Commission's recommendation to make greater use of multiyear contracting. And Mr. Wright has also expressed the administration's support for the recommendation, but didn't agree with the Grace Commission that potential termination cost should go unfunded. Now, does the Defense Department currently fund its termination costs in the first year of a multiyear contract?

Ms. GILLEECE. Mr. Chairman, there are specific provisions in the appropriations bills, in the last couple of years, as to exactly how the termination liability or cancellation ceiling should be funded. And we, in the Department, comply with that law.

Senator COHEN. Well, do you believe that they should be funded?

Ms. GILLEECE. Sir, I don't mean to not answer your question, but the responsible activity for that within the Department is in the comptroller's office. He deals in the actual money, and I would be hesitant to answer a question where I do not feel that I was an expert.

Senator COHEN. OK. Mr. Wright, you feel that they should be fully funded?

Mr. WRIGHT. Yes, I do, Mr. Chairman. I believe that what you're doing is not really establishing what the obligations authority of the Federal Government is within the budget year if you do not foresee the potential for a termination and put in at least the authority to handle it.

If there would be a change in whatever that contract or procurement would be, either by the Congress or by the Secretary of Defense, they would have to come up with a separate appropriation for the termination expense. If they did not, they would be in violation of the Impoundment Control Act.

So, therefore, we think it is proper budgeting in the way we handle it between the executive branch and the Congress to include them.

Senator COHEN. Mr. Beres, would you like to offer a few words?

Mr. BERES. Thank you. It's a pleasure being here this morning. I certainly appreciate the opportunity for GSA to say a few words at this, what I feel is a very important hearing. If I could, I'd like to limit my comments to two of the Grace Commission recommendations, those that I feel we need your support on during this coming year to enact legislation—the one dealing with multiyear contracting and the other one dealing with socioeconomic programs.

In its primary recommendation, the Commission stated that the use of multiyear contracting should be expanded in all agencies, consistent with established criteria.

As noted by the Commission, implementation of this recommendation would require additional legislation authorizing multiyear contracting where existing law prohibits its use.

GSA agrees with this conclusion that the appropriate use of multiyear contracting presents significant opportunities for Federal cost savings.

In our view, there are a number of benefits to be derived from this ability on the part of civilian agencies. First, lower prices. This

would derive from increased competition, economies of scales, the ability of contractors to amortize nonrecurring startup costs over a longer period of time.

Second, multiyear contracts would greatly reduce the agency administrative costs associated with the contract formulation process. As you know, the various activities performed by agency contracting personnel prior to the award of a Government contract are complex, time-consuming, and ultimately costly.

Third, multiyear contracts should prove advantageous to the Government in terms of the quality of vendor performance. Many contracts, particularly in the provision of services, have a long learning curve for the contractor. By eliminating annual learning curves, quality would improve over the long term for all of these types of contracts in the service area, where we would apply multiyear contracting.

Last, multiyear contracts would provide for improved continuity of supply and service support. This is important to all agencies.

A few examples of its application within GSA: GSA would use such authority in the procurement of a variety of administrative services, such as janitorial, guard, equipment maintenance, and trash removal services. Such contracts present the potential for achieving all of the previously noted benefits. GSA's public building service recently estimated a savings for these types of services could amount to \$6 million annually.

GSA would also apply multiyear contracting authority in the leasing of certain types of equipment, such as automatic data-processing equipment. Our Office of Information Resources Management has estimated that annual savings of up to \$90 million could be achieved by Federal agencies when leasing ADP under multiple-award schedules if multiyear leasing plans were available to the Federal agencies.

In the last session of Congress, GSA was pleased to support enactment of S. 2300, the Civilian Agency Multi-Year Contracting Act of 1984, which ultimately passed the Senate. During hearings on the proposed legislation, the substantial record of support for expansion of multiyear contracting authority was developed. Among those organizations which commented favorably on enactment were the Office of Federal Procurement Policy, the Chamber of Commerce of the United States, the Computer and Business Equipment Manufacturers Association, the National Academy of Public Administration, and the General Accounting Office.

Given this wide support for the concept, we would strongly urge this committee to continue its efforts to enact legislation which permits the civilian agencies to make wider use of multiyear contracts.

On the issue of the socioeconomic programs, I mentioned in the prepared testimony that a proposal to simplify small purchases has been prepared and is under consideration now in the Office of Management and Budget. I'd like to focus on two parts of the Grace Commission recommendations.

Senator COHEN. Have you made a recommendation or have you proposed a test program dealing with the socioeconomic standards?

Mr. BERES. Yes. We essentially agree with the recommendations of the Grace Commission doing away with those legislative impedi-



ments to using small purchase authority, small purchase procedures. And, as such, as a one try at getting this done, we, together with the Department of Defense and the National Aeronautics and Space Administration, have developed a test program which has been sent to OMB/OFPP for their presentation to Congress. They are currently reviewing this now. I believe Mr. Wright mentioned that earlier.

That would establish criteria and evaluation techniques raising 10 socioeconomic program thresholds up to the \$25,000 threshold.

Senator COHEN. Which agencies will be involved?

Mr. BERES. The three agencies I just mentioned, in addition to others who may want to participate. The legislation would be fashioned such that OMB would have the discretion to allow others to participate.

Senator COHEN. All right.

Mr. BERES. Thank you. I think the answer to that question pretty much summarizes our views and aspirations here for the socioeconomic programs and small purchase procedures.

Senator COHEN. Let me just ask you a couple of quick questions.

The Grace Commission recommends that common-use items, such as office equipment and supplies, should be purchased centrally through the GSA. You are already designated as the central purchasing agency for these so-called common items. But according to the Grace Commission, the problem is that GSA lacks credibility and agencies don't think that the GSA can provide what they need, so they buy it on their own.

Do you agree, No. 1, that you've got a credibility problem? No. 2, if you do, what are you doing to correct the problem?

Mr. BERES. Senator, I think anyone involved in logistic support suffers from some credibility problems, either real or perceived. We did go through some rather tough times back in the late 1970's, 1980 arena, where we were not able to meet our commitments; that is, commitments in terms of self-established goals in meeting supply support.

Senator COHEN. We're not talking about weapons systems now. We're talking about common daily items.

Mr. BERES. Yes; commercial items.

Senator COHEN. Why would any agency have to go on its own rather than turning to you? Or why would they want to? Can't you do it better, cheaper, faster?

Mr. BERES. We did go through some rough times where we weren't able to meet our commitments. After orders were placed lengthy time periods sometimes elapsed before the equipment got to them. We have turned that around. In fact, our most vocal critics now are probably our strong allies and supporters in the system, the logistics system that GSA and the Office of Federal Supply and Services plays.

Indeed, we feel confident that because of such programs as customer liaison and marketing efforts, that agencies are coming to us. We have increased the amount of sales to the Federal agencies out of our contract support efforts. Particularly in times of budget constraints, we find more and more people voluntarily coming to us to provide their needs.



Senator COHEN. But this isn't a matter of being voluntary or not, is it, Mr. Wright? I mean, isn't this part of the management side of OMB? Shouldn't OMB look at the mandatory language and say, why don't the agencies purchase through the statutorily empowered agency designated by Congress to purchase these items? Isn't that part of the management function?

Mr. WRIGHT. Yes, sir, it is, and that's one of the questions that we have been asking—among many others—as part of the management reviews this year.

The only thing I would add is that GSA does have the advantage of economies of scale. But also, they get to a point where they can carry that too far and allow service to deteriorate.

Therefore, I think they've got a tough job. And I think what they've been doing on many of their delegations, whether it be in building service or the purchasing and contracting area, has been probably in the right direction, balancing the two. We do review that with the agencies during our management reviews.

Senator COHEN. Yes; but the notion that somehow, agencies might voluntarily come to GSA for their common items, it seems to me that it's got to be a bit tighter than that, saying you will, in fact, go to GSA, unless you can show us a good reason why you're not going. Shouldn't that be the standard, rather than saying, well, I think we'll go to GSA next year. Shouldn't you, in fact, be mandating that the presumption is that they go to GSA unless they can make a clear and compelling case as to why they should buy on their own?

Mr. WRIGHT. Yes, sir, absolutely.

Senator COHEN. One other question, Mr. Beres. Are there any areas that you don't have jurisdiction over now in terms of purchase that you think that you could handle, so that your purchasing power would actually be increased rather than decreased?

Mr. BERES. That program is taken on a case-by-case basis, Senator. If everyone came to us now for the support on the items for which we do contract, we'd have all the business that we could handle. Certainly, agencies come to us from time to time and ask us to take a look at supporting through contracts programs which they currently do. We evaluate those, based on the circumstances of their resources and our resources.

To give you an example, it would probably be very inappropriate for GSA to take over contracting from the Veterans' Administration for those medical equipments and supplies where they have the resident doctors and experts as to what their needs are.

That's an extreme, on the one side. Obviously, there are extremes on the other side, where we could easily take over the procurement of items that fall within a contractual area that we already have responsibility for. So in that spectrum, there is a lot of room for management evaluation and decisions.

Senator COHEN. Mr. Mathis, I'm glad to see that we've given you the visibility that you so well deserve, high up within the Office of Management and Budget.

Is there anything that you would like to volunteer?

Mr. MATHIS. I appreciate the opportunity to have been here this morning. And like Mr. Wright endorsing Mr. Stockman, I endorse what Mr. Wright has to say. [Laughter.]

Senator COHEN. With that, you're all thanked and excused. Thank you very much.

Mr. WRIGHT. Mr. Chairman, could I add one closing comment?

This is the Subcommittee on Oversight of Government Management. You asked how do we get control of this "uncontrollable growing complexity"—

Senator COHEN. Monster.

Mr. WRIGHT. A monster. OK. That's your word. The way you do it, Mr. Chairman, is, I think, what we've been going through over the last several years, putting in a management system in the Federal Government.

As the Subcommittee on the Oversight of Government Management, you will be receiving our first report as a part of the fiscal 1986 budget. It's a serious exercise that has been in the works for 3 or 4 years. We would appreciate whatever comments you might have on it. I think that you will be pleased, or at least I hope you will be pleased, with what you see. But that is the way that you get on top of the monster. You put the management systems in the Federal Government that have not been in place since this Government was started.

Thank you.

Senator COHEN. Thank you very much, Mr. Wright.

[The prepared statements of Mr. Wright, Ms. Gilleece, and Mr. Beres follow:]



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

STATEMENT OF  
JOSEPH R. WRIGHT, JR.  
DEPUTY DIRECTOR  
OFFICE OF MANAGEMENT AND BUDGET  
BEFORE THE  
SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT  
COMMITTEE ON GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to appear before this Subcommittee to discuss certain recommendations on Government procurement made by the President's Private Sector Survey on Cost Control - the Grace Commission.

At the outset, I want to emphasize that the Grace Commission has made an invaluable contribution to the cause of increased Governmental efficiency. In many respects, the Commission has either established or confirmed the reform agenda of this Administration. Nowhere is this more true than in Federal procurement.

You asked, Mr. Chairman, that we critique six specific recommendations of the Commission - ranging from the broad issues of procurement reform to the narrower and more technical issues surrounding, for example, multi-year procurement. We have examined these issues carefully over the last 12 months in concert with the other agencies of the Executive Branch and have concluded that they are essentially on target. We can support the thrust of all six of the recommendations. Indeed, we have already implemented, or set in motion actions to implement, all six, as I will describe in a moment. Because of the breadth of the recommendations, the complexity of the issues

with which they are concerned, and the number of institutions and organizations required to effect them, however, we have not been able to confirm the specific savings estimates that Mr. Bolduc and his associates have cited. We agree, however, that in most instances, savings or cost avoidance potential is substantial.

#### Procurement Reform and the Role of OFPP

We agree with recommendation "PROC 1" that the Administration should continue its active program of procurement reform as outlined in the Uniform Federal Procurement System proposal and through the central leadership role of OFPP. As you are well aware, the Administration is strongly committed to procurement reform - a commitment that predates the work of the Grace Commission. In the last four years, the reform efforts have resulted in:

- o Development of a Uniform Federal Procurement System proposal
- o Issuance of President Reagan's Executive Order 12352, the first Executive Order in history dealing with procurement management
- o Completion and implementation of the Federal Acquisition Regulation
- o Establishment of an Interagency Executive Committee on Federal Procurement Reform to guide the overall reform effort
- o Support for the Office of Federal Procurement Policy Act Amendments and the Competition in Contracting Act, which made major improvements in the statutory base of procurement
- o Development of over 30 guidance packages for agency use on various procurement reforms

Because of the size of the procurement budget (which we estimate to be approaching \$190 billion annually) and the need for improvements in Federal procurement, we intend to continue the current emphasis on this important reform project.

With regard to OFPP, the Administration supported its reauthorization in 1983 and continues to view it as the focal point for the procurement reform effort. Moreover, the Grace Commission recommended that the Administration " ... integrate procurement reform and the role of OFPP into the existing budget/program review processes of OMB." It also suggested that we review whether OFPP should be merged directly into OMB. We have completed our review and have concluded that, as the Commission suggested, such a merger is appropriate. To make the Office more effective, give it greater stature and integrate it more thoroughly into the OMB budget and management processes, we intend, shortly, to seek Congressional authorization to make OFPP an integral part - organizationally - of OMB. This will help to assure that the Office's procurement reform initiatives are molded into the Administration's overall management reform program, and that better use is made of the Office's budgetary and staff resources.

We disagree with only one aspect of PROC 1, that the Federal Acquisition Institute should be retained in OFPP. We believe the more appropriate location for the Institute is at the General Services Administration where it will continue to receive policy direction and oversight from OFPP. This realignment was accomplished last year, as you know, by Public Law 98-191, and the approach is working well.

#### Socio Economic Programs Affecting Procurement

We concur with the Commission that lessening the impact of socio-economic programs on procurement ("PROC 2") is an area of great potential savings and one that requires serious, high level study. It is, however, a most sensitive area. We plan to set up a special subgroup of the President's Council on Management Improvement to determine what would be involved in costing-out the burden of the socio-economic programs and recommending at the next meeting of the Council the most feasible and desirable next steps. This effort will be initiated within the next few weeks.



In addition, we are proposing a test to exempt small purchases from socio-economic programs at selected procurement activities, under the testing authority provided by P.L. 98-191. With Congressional approval, the test will be used to determine the impacts on the socio-economic programs and to estimate savings. DoD, GSA and NASA have submitted a plan to us for this purpose and we are reviewing it now. We expect to notify the Congress of our specific plans, as required by Section 15 of the OFPP Act, sometime in March. As currently developed, the test plan requires a one-year waiver of statutes that did not apply to small purchases when originally enacted or later amended. The provisions affected include: wage determinations under the Davis-Bacon and Service Contract Acts, synopsis and subcontracting requirements under the Small Business Act, and affirmative action programs for veterans and handicapped workers.

#### Enhancing Implementation of Circular A-76

We strongly support the Commission's recommendations in the A-76 productivity enhancement area (PROC 18) and have implemented - or are implementing - all of them.

To gain greater support for the program, we have:

- o Incorporated A-76 into the Reform '88 program and made it a key management initiative in the budget process;
- o Expanded the number of non-DoD positions to be reviewed under A-76 from approximately 2,000 full-time equivalent positions in 1984 to 21,500 positions in 1985;
- o Included the A-76 program as part of the Administration's Productivity Improvement Program which will incorporate in 1985 efficiency studies of 15,000 full-time equivalent positions (in activities outside of DoD) that cannot be competed with the private sector because of their Governmental nature. Efficiency studies of 181,000 full-time equivalent positions are scheduled to be conducted in DoD in 1985;
- o Sought and obtained endorsement of the program by the Cabinet Council on Management and Administration and the President's Council on Management Improvement;

- o Worked actively with Agency heads to implement the program; and
- o Established a centralized Productivity Clearinghouse in OMB (with nationwide hotline) to promote the program.

In addition, we have:

- o Revised the cost study thresholds in A-76 from \$100,000 to 11 or more full-time equivalent positions.
- o Assigned to the Productivity Clearinghouse responsibility for collecting and disseminating performance work statements. The Clearinghouse is also sponsoring workshops and assisting in developing Performance Work Statements.
- o Have supported DOD efforts to persuade Congress to eliminate existing constraints on the procurement process in the A-76 area.

As a result of these actions, we believe potential cost savings and cost avoidances associated with this program for 1986-1988 are very much in line with the three year savings projected by the Grace Commission for this recommendation, that is: \$1.1 billion.

#### Simplifying DoD's Procurement Regulations

We agree that the procurement process needs to be simplified and competition increased. We believe that all of the problems identified by the Grace Commission in "OSD 17" - including upgrading the Federal procurement workforce - are addressed by President Reagan's E.O. 12352, which is being implemented under the guidance of our Office of Federal Procurement Policy. Regulations are in the process of being simplified, reduced in number and made consistent with the Federal Acquisition Regulation System. Development of a professional procurement work force is a high priority under the Executive Order.

#### Enhancing Competition Through Functional Specifications

We concur fully with the Grace Commission recommendation ("PROC 22") of the need to shift from the use of complex design specifications to simplified performance

specifications. OMB Circular A-119, issued in October 1982, encourages this approach and the major specification management agencies have active conversion programs. We will continue to emphasize the need for performance in lieu of design specifications. Clearly this specification effort will help to hold costs down. The magnitude of cost savings and avoidance, however, are very difficult to identify. One problem that Congress can help with in furthering this program is to remove the restrictions placed in the last two DOD Appropriation Bills. These restrictions forbid the use of commercial market acceptability criteria in specifications and sometimes caused us to use detailed specifications when simple commercial item descriptions would work better.

#### Greater Use of Multi-year Contracting

With respect to multi-year contracting, we generally support the Grace Commission ("PROC 4") that this approach should be expanded to the civilian agencies. You may recall, Mr. Chairman, that we indicated our support for this approach last March 13, when we testified before the Subcommittee on S.2300. We regret that the bill, which was passed by the Senate, was not acted upon by the House. It would have provided the authority for multi-year contracting to the civilian agencies with the protections we feel are necessary to the judicious use of multiyear contracting.

We also agree that DoD and the Services should carefully monitor multi-year contracting authority and use the discounted cash flow methodology to evaluate candidate programs. We understand that they have established that capability and would recommend those practices be extended to the civilian agencies with new authority to use multi-year contracting.

We do not agree with the Grace Commission, however, that existing procedures should be simplified to allow termination costs to go unfunded. In our view, such an approach would be contrary to the budget decision procedures now in use to identify and approve programs for multi-year contracting. Budget requests for multi-year procurement programs should include the termination liability value of components in the advance buy. This practice provides necessary flexibility to Congress, OMB, and the procurement agency to make programmatic and budgetary adjustments to a program without the necessity of appropriating additional budgeting authority to fund cancellation charges for recurring costs.

We also believe that agency procurement executives through the Federal Procurement Data System are able to provide sufficient monitoring capability of multi-year contracting programs. OFPP need not play a role in this regard.

Finally, we agree that the savings potential associated with expanding the program is substantial - based upon our experience with the program to date. Whether it will approach \$1.8 billion is something we are still evaluating.

I will be pleased, Mr. Chairman, to respond to any questions you or your colleagues may have.

## ATTACHMENTS



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

CONGRESS: LET'S GET SERIOUS ABOUT GOVERNMENT EFFICIENCY

By Joseph R. Wright, Jr., Deputy Director

Why would the Department of Defense pay \$1.60 for a white teeshirt when it could get exactly the same thing for \$1.22, saving \$3.8 million a year? Why does the National Park Service still charge the 1972 fee of only \$1 to spend a day in Cape Cod National Seashore while inflation has since raised other consumer prices 138 percent? Why does the Coast Guard inspect commercial ships and test and license their crews absolutely free of charge?

The answer to all three questions is because Congress has stonewalled on these and many, many other efficiencies proposed by the President to reduce Government costs and the resultant burden on taxpayers. Let's be honest with the American people about who is and who is not serious about making Government work better for less. The President is. Congress claims it is, but as the old saying goes, actions speak louder than words, and Congress' inaction over the past two years on Government efficiency issues has been eloquent.

Preservation of the status quo for everyone cannot continue to dominate the actions of Congress if we are to deal responsibly as a nation with the immense challenges of this decade and beyond. Territorial and special interests must at some point yield to the national interest. Let me illustrate the problem with three examples: procurement of common goods, user fees, and unemployment "floors."



The Federal Government spends about \$26 billion a year to procure food, clothing, and thousands of similar commonly-used items. Most of these items are commercially available off-the-shelf at prices lower than if they were made-to-order. For example, in 1983 the Department of Defense successfully used commercial descriptions to reduce its \$4.9 billion food bill by about \$22.7 million and its medical supply costs by another \$19.2 million. However, in 1983, 1984 and 1985 appropriations bills, Congress prohibited DOD from requiring small businesses to have a commercial market before they can sell to the Government. As a double whammy, it also prohibited DOD from trying out made-to-order products before buying. This has the effect of prohibiting DOD from using short commercial descriptions of common products it wishes to buy.

To be sure of receiving acceptable products, DOD was thus forced to revert to using detailed specifications. Now, instead of using a one-page request for handkerchiefs, DOD must use an 18-page specification that amounts to instructions for designing and sewing a handkerchief. Likewise for boots, bedpans, catsup and mens' briefs, which incidentally needed a 24-page specification.

Quality of the delivered product may also suffer. Inexperienced or corner-cutting contractors have in the past delivered faulty products such as desks without handles and lawn tractors that operated only on perfectly flat surfaces, because the specs inadvertently omitted such obvious characteristics. Typically, these products came from companies that manufacture only for the Government. Private sector customers can't use desks without handles. Neither can the Government. Purchase of commercially-proven, off-the-shelf items wherever possible helps eliminate this problem.

The restriction stems from one Senator's desire to protect a single office furniture manufacturer in his State. The result? Reduced competition and quality, and increased costs and paperwork. Taxpayers are thus forced to forgo millions a year in proven cost reductions. A year ago DOD proposed compromise language to accommodate the Senator's concern and still permit use of commercial descriptions. The compromise attempt was ignored in passage of the latest appropriations bill.

A second area where the President seeks to apply good business practice and exercise the principle of fairness is user fees. This Administration is committed to the philosophy that those who benefit directly from a specific Federal service should pay their fair share of the cost of providing that service. For example, the entrance fee to Yellowstone Park has been \$2 for the last 12 years. Meanwhile, costs for operating that park have risen 261 percent. Extrapolating that example to the 335 National parks and other public areas covering nearly 80 million acres, the millions of urban dwellers and others who seldom use these parks are unfairly shouldering the cost burden for those who do.

Congress has for five years prohibited raising the National Park Service entrance fees by so much as one cent, and for some Federal lands allows no fees at all. According to a 1982 GAO report, more than \$20 million a year could be collected by the Park Service from higher fees, longer collection hours, and more units charging fees. The President will continue to seek removal of the legislative barriers to recovery of more reasonable portions of its park operating costs from the visitors to those parks.

In the same vein, the Administration has for the last three years proposed that the Transportation Department be permitted to recover some of its costs of providing marine services, as it does in the highway and air transportation sectors. Currently, over 98 percent of DOT's highway budget is user-financed, while about 80 percent of its air services are user-financed. Less than one percent of the cost of Coast Guard marine services is borne by those who directly benefit from them.

The Administration recognizes the legitimate concerns of the maritime constituencies, and thus is not proposing to impose fees to recover the cost of each and every Coast Guard service. Only certain direct services were covered by the Administration's latest legislative proposal, such as issuance of regatta permits, icebreaking on request, and transfer of hazardous cargo. From our original 1982 proposal to ultimately recover \$800 million a year in both direct and indirect costs, the Administration compromised down to about \$200 million in 1983 and then further compromised in 1984 with a proposal that would recover \$50 million a year in specific direct services where cost allocation is clear-cut. None of these compromises was seriously considered by Congress. The legislation was never even brought up for a vote in committee.

Given the Congress' persistent opposition, the Administration submitted no Coast Guard user fee legislation with the latest budget. Instead, we plan to use existing administrative authority to recover a minimal level (about \$10 million) of program costs. The Administration continues to believe in the inherent fairness of the user fee concept as a means of shifting the tax burden away from the general taxpayer.

Similar obstructionism has been evident in Congress' response to agencies' efforts to find the most efficient way of getting a job done by competitively comparing the cost of doing it in-house with the cost of having a commercial firm provide the service. Such comparisons, done under the "A-76" program, have proven capable of reducing operating costs by an average of 20 percent regardless of who "wins" the competition. However, Congress has forbidden the Defense Department from contracting for security guards and firefighters, even where they are readily available from competent local municipalities or contractors. Coast Guard, VA, GSA and other agencies are also prohibited from contracting out by provisions in appropriations bills. Other legislation pending on Capitol Hill would preempt agencies from making cost comparisons on such routine services as snow removal, vehicle maintenance, and trash disposal.

Another device Congress has used is attaching employment "floors" to appropriations bills, requiring more employees in a specified program area than are needed. Such "floors" have for the last few years been applied to several Department of Energy programs. They are a remnant of earlier disputes over funding levels and priorities -- disputes largely resolved now because of President Reagan's successes in energy policy. However, some of the floors remain, hamstringing DOE's efforts to allocate its personnel most effectively and reduce unnecessary Government spending.

Similar impediments to more efficient use of personnel permeate appropriations bills. Employment floors or their equivalent exist for the Forest Service, the Soil Conservation Service, the Departments of Education, Health and Human Services, and Interior, VA medical care functions, and others. As a result, the Administration may have to hire thousands of persons in 1985 who are not needed to carry out the functions of Government.

The President remains firm in his determination to restore balance and managerial excellence to Government. He is introducing administrative efficiencies that make good sense, impose no unreasonable burdens, and benefit the more than 90 million Americans who pay taxes each year. Congress must agree to give change a chance. Its tendency to preserve the status quo at all costs is not solving any problems -- it's part of the problem.

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## FEDERAL ACQUISITION REGULATION (FAR) PROJECT

- Launched Jan. 1978 to consolidate all common regulations included in the Defense Acquisition Regulation, the NASA Procurement Regulation, and the Federal Procurement Regulation (civilian agencies).
- Completed in three phases:
  - o Phase I - initial draft for public comment
  - o Phase II - project office review of public comment and redraft
  - o Phase III - "Executive Review" - final review and drafting by DOD, GSA & NASA
- E.O. 12352 Mar. 1982 required completion of the FAR by end of 1982
- Published in the Federal Register Sept 1983
- The FAR Project is a procurement regulatory reform program designed to:
  - o Reduce the proliferation of procurement regulations among and within executive agencies.
  - o Provide a single Government-wide regulation in simple, clear and understandable English.
  - o Make it easier to do business with the Government, particularly for small and minority business firms as well as large business.
- The FAR System is a single regulatory system for all executive branch agencies expending appropriated funds by contract. Its features include:
  - o A single Federal Acquisition Regulation (FAR), applicable to all agencies, promulgated jointly under the regulatory authorities of DOD, GSA, and NASA in a new Title 48 of the Code of Federal Regulations.
  - o Agency implementing regulations must be published in assigned Chapters of Title 48 of the CFR and must not conflict with, restate, or paraphrase anything in the FAR.
  - o Agency headquarters' level regulations must contain these same restrictions on lower level regulations thus reducing redundancy and proliferation.
  - o Agency regulations must conform to the FAR numbering system format, and clear writing conventions.
- Effective date Apr. 1, 1984
- The FAR is in a continuous phase of revision.
  - o Major procurement legislation passed by the 98th Congress (P.L. 98-369, Competition in Contracting Act, P.L. 95-507 & 98-525). Over 100 other procurement related bills were introduced in the 98th Congress.
  - o There are over 200 regulatory revisions currently under consideration by the FAR Councils.



TESTIMONY OF  
MS. MARY ANN GILLECE  
DEPUTY UNDER SECRETARY OF DEFENSE (ACQUISITION MANAGEMENT)  
BEFORE THE  
SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS  
SUBCOMMITTEE ON GOVERNMENT OVERSIGHT  
JANUARY 23, 1985

"NOT FOR PUBLICATION UNTIL RELEASED BY THE SUBCOMMITTEE"

MR. CHAIRMAN, I VERY MUCH APPRECIATE THIS OPPORTUNITY TO APPEAR BEFORE THIS SUBCOMMITTEE TO DISCUSS THE DEPARTMENT OF DEFENSE POSITION ON CERTAIN OF THE RECOMMENDATIONS OF THE PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL, BETTER KNOWN AS THE GRACE COMMISSION.

AS YOU NOTED IN YOUR INITIAL LETTER TO ME, THE REPORT ADDRESSES A VERY WIDE RANGE OF ISSUES. CONSEQUENTLY, YOU LIMITED YOUR INITIAL FOCUS TO 10 BROAD ISSUES, 8 OF WHICH YOU ASKED ME TO ADDRESS TODAY. IN THE INTEREST OF TIME, I WILL CONFINE MY ORAL TESTIMONY TO A SHORT GENERAL STATEMENT ON THE OVERALL GRACE COMMISSION EFFORTS AND THESE 8 SPECIFIC ISSUES. I WILL SUBMIT WRITTEN COMMENTS FOR THE RECORD WHICH FURTHER ADDRESS EACH OF THE EIGHT ISSUES INDIVIDUALLY.

FIRST LET ME SAY THAT THE DEPARTMENT APPLAUDS THE WORK OF THE GRACE COMMISSION. IN ANY ORGANIZATION AS LARGE AND COMPLEX AS DOD, THERE IS ALWAYS ROOM FOR IMPROVEMENT. OF COURSE, WE ARE CONSTANTLY IN THE PROCESS OF INTERNALLY AUDITING OURSELVES THROUGH A VARIETY OF SELF-EXAMINATION FUNCTIONS

AND ORGANIZATIONS SUCH AS THE DOD INSPECTOR GENERAL, BUT WE RARELY HAVE THE OPPORTUNITY TO GET THE POINT-OF-VIEW OF OUR COUNTERPARTS FROM THE PRIVATE SECTOR. THIS MAKES THE GRACE COMMISSION BOTH UNIQUE AND PARTICULARLY VALUABLE TO US AS TOP MANAGERS IN GOVERNMENT.

AND, I AM SOMEWHAT HEARTENED, AS ONE OF THOSE TOP MANAGERS, TO REPORT THAT WE SAW VERY FEW SURPRISES IN THE COMMISSION REPORTS. THERE WAS VERY LITTLE THAT WAS NEW TO US AND VERY FEW RECOMMENDATIONS THAT WE HAD NOT ALREADY ACTIVELY CONSIDERED. MANY WERE ALREADY BEING IMPLEMENTED. IN FACT, OF THE EIGHT ISSUES WHICH YOU ASKED ME TO ADDRESS, WE DISAGREED WITH ONLY ONE. THAT ONE (OSD #15) DEALS WITH A PROPOSAL FOR A SWEEPING REORGANIZATION OF THE TOTAL ACQUISITION PROCESS WITHIN THE ENTIRE AGENCY.

THE COMMISSION APPARENTLY PERCEIVED THAT A MAJOR SOURCE OF DIFFICULTY IN THE ACQUISITION PROCESS IS TRACEABLE TO THE ORGANIZATION STRUCTURE. WE'RE NOT CONVINCED OF THAT YET. IT IS FALSE ECONOMY TO ATTEMPT TO "REORGANIZE" YOUR WAY OUT OF PROBLEMS. FURTHERMORE, THE COMMISSION CLAIMED NO SAVINGS AS A RESULT OF IMPLEMENTATION OF THIS SPECIFIC RECOMMENDATION. NOT ONLY DO WE AGREE THAT THERE ARE NO SAVINGS TO BE HAD, BUT THE RECOMMENDATION IGNORES WHAT WE BELIEVE WOULD BE VERY SUBSTANTIAL IMPLEMENTATION COSTS IN TERMS OF DISRUPTION OF OPERATIONS AND DISPLACEMENT OF PEOPLE.

IN THE ABSENCE OF A CLEAR ADVANTAGE OF ONE ORGANIZATIONAL ARRANGEMENT OVER ANOTHER, WE BELIEVE THAT IT SHOULD BE A PREROGATIVE OF MANAGEMENT TO ORGANIZE AS IT SEES FIT. WE BELIEVE THE COMMISSION'S ORGANIZATIONAL VIEWS WERE SOMEWHAT COLORED BY THE FACT THAT THEY WERE LOOKING AT THE ACQUISITION

FUNCTION IN ISOLATION AND DIVORCED FROM THE BROADER MISSION OF THE DOD. OUR  
FIRST MISSION IS TO . ENSURE THE  
NATIONAL SECURITY. I BELIEVE THAT WE SHOULD KEEP AN OPEN MIND ON THIS ISSUE.

AS I MENTIONED BEFORE, WE ARE IN FUNDAMENTAL AGREEMENT WITH THE  
COMMISSION ON THE OTHER 7 ISSUES, WHICH YOU ASKED ME TO ADDRESS. WHILE, WE  
RESERVE THE RIGHT TO MAKE MINOR ADJUSTMENTS ON SOME OF THE SPECIFICS, WE  
BELIEVE THAT THE OVERALL RECOMMENDATIONS ARE SOUND. MANY WERE ALREADY BEING  
IMPLEMENTED BY DOD. EXAMPLES INCLUDE USE OF MULTI-YEAR CONTRACTING,  
IMPLEMENTATION OF OMB CIRCULAR A-76, INCREASED USE OF PERFORMANCE  
SPECIFICATIONS, AND SIMPLIFICATION OF THE PROCUREMENT REGULATIONS. THE  
COMMISSION RECOGNIZED THIS AND, IN FACT, SINGLED OUT DOD AS A LEADER AMONG THE  
FEDERAL AGENCIES ON IMPLEMENTATION OF SEVERAL OF THE RECOMMENDATIONS.

WHERE WE DO DISAGREE WITH THE COMMISSION, HOWEVER, IS ON THE AMOUNT OF  
SAVINGS TO BE REALIZED AS A RESULT OF THEIR RECOMMENDATIONS. WE BELIEVE THAT  
THE SAVINGS ARE GROSSLY OVERSTATED FOR THREE BASIC REASONS:

FIRST, THE ESTIMATES IN MOST CASES ARE HIGHLY SUBJECTIVE, AND (IN OUR  
OPINION) OPTIMISTIC; SECOND, THE ESTIMATED SAVINGS ARE OFTEN DUPLICATED IN  
SIMILAR RECOMMENDATIONS FROM ONE REPORT TO ANOTHER; AND, THIRD, THE COMMISSION  
FAILED TO GIVE CREDIT FOR SAVINGS WHICH WOULD HAVE ACCRUED ANYWAY AS A RESULT  
OF OUR OWN INTERNAL IMPROVEMENTS.

FOR EXAMPLE, ONE RECOMMENDATION IN THE PROCUREMENT REPORT (PROC 8-2)  
CONTAINS A RECOMMENDATION TO REVISE THE SELECTED ACQUISITION REPORT (SAR) TO

MAKE IT MORE MEANINGFUL. THIS WAS PART OF AN OVERALL RECOMMENDATION (PROC 8) TO "STRENGTHEN THE COST ESTIMATING AND SCHEDULING FUNCTIONS IN DOD." THE COMMISSION ESTIMATES THAT NEARLY \$3 BILLION COULD BE SAVED OVER THREE YEARS BY IMPLEMENTING THIS RECOMMENDATION. THIS WAS BASED ON A BELIEF THAT AN ARBITRARY 2-3% OF ANNUAL SPENDING ON WEAPONS SYSTEMS WOULD RESULT. WE BASICALLY AGREED WITH THIS RECOMMENDATION, BUT BELIEVE THAT, WHILE IMPLEMENTATION WOULD UNDOUBTEDLY IMPROVE THE PROCESS, NO SPECIFIC, SEPARATELY IDENTIFIABLE SAVINGS WOULD RESULT. BUT BEYOND THIS PROBLEM, ESSENTIALLY THE SAME RECOMMENDATION IS REPEATED IN THE OSD REPORT (OSD-22-7) AND THE ARMY REPORT (ARMY 10-3) AND CREDIT TAKEN FOR THE SAME (SUSPECT) SAVINGS TWICE MORE. IN POINT OF FACT, I'M NOT SURE THE QUESTION OF WHAT SPECIFIC SAVINGS--IF ANY-- WILL RESULT FROM IMPLEMENTATION OF THE COMMISSION RECOMMENDATIONS IS VITALLY IMPORTANT. WE CAN--AND PROBABLY WILL--ARGUE THE SPECIFICS FOR A LONG TIME TO COME. I BELIEVE THE IMPORTANT THING IS THAT (WITH THE EXCEPTION OF THE ONE RECOMMENDATION PREVIOUSLY DISCUSSED) DOD IS PROCEEDING WITH IMPLEMENTATION OF ALL OF THE RECOMMENDATIONS YOU ASKED ME TO LOOK AT TODAY. WE MAY NEVER BE ABLE TO SEPARATELY QUANTIFY HOW MUCH EACH ONE CONTRIBUTED TO ANY SAVINGS WHICH MAY EVENTUALLY BE REALIZED; BUT, OVERALL, I'M CONVINCED THAT EACH IS IMPORTANT IN ITS OWN RIGHT AND DESERVING OF OUR SWIFT ATTENTION.

IN SUMMARY, WE BELIEVE THE GRACE COMMISSION IS A VALUABLE MANAGEMENT TOOL WHEN APPLIED INTELLIGENTLY. FOR THE MOST PART, WE DO NOT DISAGREE WITH THE THRUST OF THEIR RECOMMENDATIONS. WE DO BELIEVE THAT THE QUOTED SAVINGS ARE SOMEWHAT SUSPECT, BUT WE DON'T THINK THAT SHOULD OVERSHADOW THE VALUE OF THE EFFORT TO OUR MUTUAL GOAL: IMPROVEMENT OF ACQUISITION MANAGEMENT IN THE DEPARTMENT OF DEFENSE.



THIS CONCLUDES THE ORAL PORTION OF MY TESTIMONY. I WILL SUBMIT MORE  
DETAILED INFORMATION ON EACH OF THE 8 SPECIFIC ISSUES FOR THE RECORD.

DoD Comments

on

Grace Commission Recommendations

Related to

Acquisition

Issue: Improving the Organization of the Acquisition Function within the Department of Defense

Grace Recommendation Number: OSD-15

Summary of Recommendation:

The Department of Defense should initiate a program to modernize and streamline the total acquisition process. It is our assessment that consolidation of the management of the acquisition process within the Office of the Secretary of Defense (OSD) would improve program efficiency and provide opportunities for significant cost savings.

The recommendation suggests four alternative acquisition procedures for DoD consideration, including:

- A uniform system of procurement.
- A commodity approach to procurement, e.g., Air Force procurement of all aircraft.
- Consolidation of procurement and production into a single new agency reporting to OSD.
- Consolidate acquisition at the OSD level including research and engineering.

DoD Position: Disagree

While the proposal may improve the DoD focus of acquisition, no supporting rationale is presented for saving money or making the process itself more effective. The present acquisition process is geared to meet critical national security requirements. The disruption that would be caused by the creation of an OSD organization to accomplish weapon systems acquisitions would be significant and possibly preclude the achievement of any expected benefits from centralization. Inefficiencies that do exist are being identified and corrected by OSD and Service initiatives.

However, we are deferring final judgment of the recommendation pending careful consideration of the suggested alternatives, including the costs and benefits of each alternative, the functional realignments that would be required, and the impacts of realignment on service-mission performance.

Estimated 3-Year Savings:

Grace Commission: None claimed  
DoD: None claimed

Issue: Lessening the Impact of Socio-Economic Programs on the Acquisition Process

Grace Recommendation Number: Procurement 2

Summary of Recommendation:

In addition to the laws and regulations governing federal procurement, the government process is used as a vehicle to promote social change--through some 80 socio-economic programs impacting procurement.

Four recommendations are made under Procurement 2. Two suggest that analysis of the burden and cost benefit of socio-economic programs is necessary and that there may be more cost effective means of implementing some socio-economic programs than through use of the procurement process. The two remaining recommendations discuss tying dollar thresholds for existing socio-economic programs to the ceiling for simplified small purchase procedures.

DoD Position: Agree

DoD will support study of more cost effective application of socio-economic programs and identification of programs not achieving their objectives either from a cost-benefit perspective or in an absolute sense. There may be more cost-effective means to implement some socio-economic programs but whether significant absolute savings can be identified is questionable.

DoD agrees with the recommendation that the dollar threshold of socio-economic programs should be increased to the threshold of small purchases, with such thresholds being indexed thereafter. Inflation has undermined the intent of many of these socio-economic thresholds. Simplified small purchase procedure thresholds and socio-economic thresholds should be compatible. We support legislation to raise the thresholds and in the alternative support testing under OFPP authority.

Estimated 3-Year Savings:

Grace Commission: \$847 mil

DoD: None claimed

Basis for Difference: Estimated savings are uncertain and the share which could fall to DoD cannot be determined.

Issue: Encouraging Implementation of OMB Circular A-76 on Contracting Out

Grace Recommendation Numbers: OSD-7; Procurement 18

Summary of Recommendation:

Under Procurement 18, three recommendations are directed toward improving implementation of policies and procedures for determining the government's use of the private sector (as directed in OMB Circular A-76), by:

- Mounting a campaign through OFPP, the executive agencies, and private industry to gain support for the A-76 program from Congress, the public, government unions, and local governments.
- Raising the present threshold for cost comparison studies of activities performed in-house versus the private sector to 10 full-time employee equivalents (approximately \$250,000) and having the threshold applicable in both DoD and civilian agencies.
- Streamlining cost comparison study procedures through development of more standardized performance work statements and study of the use of computer processing of study data.

Under OSD-7, the Commission recommends that the Department of Defense seek legislation that will terminate existing constraints on DoD implementation of the Office of Management and Budget (OMB) Circular A-76. In recent years, DoD efforts to implement OMB Circular A-76 have been restricted by various legislative requirements.

DoD Position: Agree with modification

DoD is seeking an active and aggressive A-76 program through added support and streamlining studies and procedures; and notes the report's finding that DoD has led other agencies in its implementation.

As the report points out, DoD has been subject to Congressional requirements not imposed on civilian agencies. DoD supports removal of existing constraints on DoD implementation of OMB Circular A-76.

Overall, the A-76 program must be operated and evaluated within the context of national defense requirements. Within DoD, application of A-76 is one aspect of the total manpower utilization process used to determine the proper mix of essential military, in-service civilian, and contract work force in support of our mission.

Estimated 3-Year Savings:

Grace Commission: \$1,176 mil (Proc 18); \$7,128 mil (OSD-7)  
DoD: None claimed

Basis for Difference: Removal of previous Congressional restriction was contingent upon DoD's implementation of the A-76 program at a slower pace. Thus, all conversions that DoD can practically expect to make are already planned. Additional savings are not anticipated.



Issue: Simplifying the Regulatory RequirementsGrace Recommendation Number: OSD-17Summary of Recommendation:

The Department of Defense should take appropriate action to simplify the complex regulatory system which governs the acquisition of weapons systems. This is essential for improving and expanding the competitiveness of the industrial base.

The task force proposes the following specific actions:

- Replace detailed procedures with policy statements to provide general guidance.
- Professionalize procurement work force.
- Limit the mandatory flow down of contractual provisions to subcontractors.
- Where there is adequate competition, use price analysis techniques as a less expensive alternate to cost analysis.
- Simplify contract clauses, forms, and contract language.

DoD Position: Agree

DoD concurs in the general thrust of the recommendation. Efforts have been made and are continuing to be made to reduce the regulatory and statutory requirements that burden the procurement process without commensurate benefit. The initiatives taken in the DoD Acquisition Improvement Program continue to be pursued. On March 17, 1982, the President issued Executive Order 12352, "Federal Procurement Reforms." He ordered reforms in government procurement to ensure effective and efficient spending of public funds. These reform efforts are ongoing.

Estimated 3-Year Savings:

Grace Commission: None claimed  
DoD: None claimed

Issue: Enhancing Competition in Contracting through the use of Functional or Performance Specifications

Grace Recommendation Numbers: OSD-20; Procurement 22

Summary of Recommendation:

Under Procurement 22, the Commission recommends a comprehensive program to shift to simpler specifications where warranted.

Under OSD-20, the Commission recommended that DoD mandate the use, where possible, by all Services, of common hardware components, subsystems, equipment, and other parts in order to minimize initial acquisition and life-cycle costs. The use of military standards and specifications should be decreased.

DoD Position: Agree (Procurement 22); Agree with modification (OSD-20)

The report acknowledges significant DoD progress in specification simplification. However, simplified specifications, when applied without discretion, can result in the receipt of unacceptable products. The recommendation does not fully recognize the relationship of specifications to associated acquisition considerations and, therefore, is optimistic about the potential for specification simplification.

Recommendation Procurement 22 reinforced DoD's ongoing programs to simplify specifications and to work closely with industry to develop mutually acceptable common-use standards. In both of these areas, DoD had previously issued policies and guidance.

With respect to Recommendation OSD-20, DoD components continue their efforts to implement the standardization program as directed by current OSD directives. The objective is the development and production of standard components and subsystems.

Estimated 3-Year Savings:

Grace Commission: \$131 mil (Proc 22); \$7,513 mil (OSD-20)  
DoD: None claimed

Basis for Difference: Grace Commission estimates were subjective assessments and covered initiatives, most of which were already well underway within DoD. Although some savings may result, it is not possible to quantify.

Issue: Improving Cost Estimating, Scheduling, and Risk Management Techniques

Grace Recommendation Numbers: OSD-22; Procurement 8

Summary of Recommendation:

Under Procurement 8, the Commission recommends that OSD and the Services strengthen the cost and schedule functions of each Service, institute greater discipline over cost estimates and schedule development to produce "most likely" results, improve "early warning" indicators to enhance management prerogatives and to exercise cost control.

Recommendation OSD-22 states that the Secretary of Defense should establish procedures to ensure more accurate estimates of weapons costs in order to permit better planning and reduce cost overruns. Specifically, provision should be made for establishing a new production cost baseline at Milestone III. The Secretary should also establish procedures to create a policy-oriented data base for use by DoD management. The Department of Defense (DoD) Comptroller should be assigned the responsibility for analyzing the affordability of proposed weapons systems and for monitoring actual costs versus estimated costs.

DoD Position: Agree with modification

This is a good recommendation but savings are questionable. DoD has taken a number of steps to improve cost estimates and will continue to support ongoing efforts to refine cost estimating methodologies. The extent to which the recommendations should be implemented is under review.

Estimated 3-Year Savings:

|                   |                                          |
|-------------------|------------------------------------------|
| Grace Commission: | \$7,185 mil (for OSD-22 and 23 combined) |
|                   | \$2,940 mil (Proc 8)                     |
| DoD:              | None claimed                             |

Basis for the Difference: In addition to being duplicative, the Commission savings figures are subjective estimates based on arbitrary percentages applied to the projected total weapons systems budget. We see no basis to assume that projected savings will be realized by simply improving our program cost estimates.

Issue: Increasing Stability in the Acquisition Process through Greater use of Multiyear Contracting

Grace Recommendation Numbers: OSD-23; Procurement 4

Summary of Recommendation:

Recommendation OSD-23 states that DoD should commit to a stable five-year spending plan for the acquisition of weapons systems at economical production rates. DoD should focus the attention of Congress on any significant increase in costs that would result from proposals to change the plan. Critical to achieving such a plan for program stability is the DoD's ability to relate financial affordability to proposed new systems early in the budgetary cycle.

Recommendation Procurement 4 advocates expansion of the use of multiyear contracting to all federal agencies.

DoD Position: Agree

Program stability is highly desirable and we continue to strive for this stability. We are strong advocates of multiyear contracting where it makes sense. Our efforts are consistent with the thrust of these recommendations.

Estimated 3-Year Savings:

|                   |                                       |
|-------------------|---------------------------------------|
| Grace Commission: | \$7,185 mil (OSD-22 and 23 combined); |
|                   | \$3,073 mil (Proc 4, DoD share only)  |
| DoD:              | None claimed                          |

Basis for Difference: Implementation cannot be associated with the specific cost savings suggested by the report--although savings certainly accrue from prudent application of multiyear contracting.

Issue: Improving Program Management by Strengthening the Role Responsibility, Authority, and Accountability of the Program Manager

Grace Recommendation Number: Procurement 9

Summary of Recommendation:

The OSD and the Services should fully integrate the program management organization/system in each Service to actively support and underwrite the effectiveness of PMs and strengthen discipline and delegation of authority in the acquisition process.

DoD Position: Agree

While we agree to the principle of improved integration, the degree to which this is practical or desirable depends on each of the Services. Fully integrated program management organizations may be desirable from the standpoint of assembling all required resources in one organization to accomplish a specific job. It is done where the size and importance of a program makes this approach cost effective. In other cases, a matrix approach (which is also used on many programs in the private sector) is more efficient.

Estimated 3-Year Savings:

Grace Commission: \$980 mil  
DoD: None claimed

Basis for the Difference: Grace Commission savings are judgmental. A fully integrated PM office across all DoD could increase costs. Better people and better management should result in cost savings. We just do not know how to quantify it.

STATEMENT OF  
ALLAN W. BERES  
ASSISTANT ADMINISTRATOR  
OFFICE OF ACQUISITION POLICY  
GENERAL SERVICES ADMINISTRATION  
BEFORE THE  
OVERSIGHT OF GOVERNMENT MANAGEMENT SUBCOMMITTEE  
COMMITTEE ON GOVERNMENTAL AFFAIRS  
JANUARY 23, 1985



Mr. Chairman, I am Allan Beres, Assistant Administrator for Acquisition Policy, General Services Administration (GSA). This morning it is my pleasure to provide you an overview of GSA's reaction to several of the Grace Commission's recommendations concerning procurement. My testimony will deal generally with the seven Commission's recommendations on which you requested GSA comment.

Centralizing the acquisition of "common use" items through the General Services Administration

The Grace Commission found that, in most cases, civilian agency procurement activity has evolved into a "pragmatic mix of centralized and decentralized purchasing." The Commission accordingly recommended that measures be taken to bring the centralization of Government procurement more in line with the practices of the private sector.

GSA agrees with the Commission that more thought should be given as to which items should be procured centrally, as well as how those items should be provided to the customer agency. Market research techniques such as retrieval of information from the Federal Procurement Data System are used by GSA to identify high volume commodity purchases by Federal agencies in the open market.

Another effort referred to by the Commission was the joint GSA-Department of Commerce (DOC) pilot study on agency procurement. The intent of this study was to identify commodity areas in which

GSA could expand contract coverage. GSA's review of DOC's procurements identified a contract expansion potential in the publications area, among others, valued in excess of \$1,000,000.

GSA realizes that much more needs to be done. Since 1981, our Office of Federal Supply and Services (FSS) has dramatically improved its responsiveness to customer agencies. FSS' Customer Base Expansion Project, begun in 1983, is attempting to capture a larger share of the Government's \$12 billion in supply and service procurements. At the end of FY 1984, about \$5.7 billion of the Government's common use purchases were through FSS.

Increasing stability in the acquisition process through greater use of multiyear contracting

As part of its analysis of weapons system acquisition issues, the Grace Commission considered the concept of multiyear contracting and concluded that expanding its use could be beneficial to Government procurement. In its primary recommendation, the Commission stated that the use of multiyear contracting should be expanded in all agencies, consistent with established criteria. As noted by the Commission, implementation of this recommendation would require additional legislation authorizing multiyear contracting authority where existing law prohibits its use.

GSA agrees with the Commission's conclusion that the appropriate use of multiyear contracting presents significant opportunities for Federal cost savings, and strongly endorses its primary recommendation. In our view, there are many potential benefits

to be derived from the use of multiyear contracting, which are generally denied to the civilian agencies because of fiscal law restrictions. I will review them briefly.

First, when used appropriately, multiyear contracts may result in lower prices. Such reductions may be derived from increased competition, economies of scale, improved contractor productivity, or a contractor's ability to amortize nonrecurring start up costs over a longer period of time than is provided by a conventional annual contract.

Second, in many cases, multiyear contracts will greatly reduce agency administrative costs associated with the contract formulation process. As you know, the various activities performed by agency contracting personnel prior to the award of a Government contract are complex, time consuming, and ultimately costly. Significant savings should result if such activities need be performed only once every three or five years rather than annually.

Third, multiyear contracts should prove advantageous to the Government in terms of the quality of vendor performance. Many contracts, particularly those for the provision of services, experience a "learning curve" phenomenon where a new contractor's performance improves steadily as its workers gain experience with the peculiarities of the Government's work requirements. Contracts for periods in excess of one year should permit a

longer period of superior performance than would annual agreements. Furthermore, a longer performance period coupled with reduced contract formation burdens will enable agency personnel to do a better job of administering a Government contract to ensure compliance with its terms.

Lastly, multiyear contracts would provide for improved continuity of supply and service support. The complexities of the annual procurement process provide a high degree of risk for the disruption of such support because of a procuring activity's inability to provide timely contract coverage. A frequent consequence of such disruption is the award of a noncompetitive contract to provide temporary contract coverage pending conclusion of a competitive procurement. Multiyear contracts should greatly reduce the frequency of such situations.

For the civilian agencies, we envision numerous applications of multiyear contracting authority in the procurement of supplies and services. A few examples of its application in the General Services Administration may be of interest to the Subcommittee.

GSA would use such authority in the procurement of a variety of administrative services such as janitorial, guard, equipment maintenance and trash removal services. Such contracts present the potential for achieving all of the previously noted benefits. GSA's Public Buildings Service recently estimated that savings for these types of services could amount to \$6 million annually.

The General Accounting Office recognized the potential for comparable savings in such contracts in a report issued in 1978.

GSA would also apply multiyear contracting authority in its leasing of certain types of equipment such as automated data processing equipment. Our Office of Information Resources Management has estimated that annual savings of up to \$90 million could be achieved by Federal agencies when leasing ADPE under GSA's ADP under ADP multiple award schedules if multiyear leasing plans were available to the Federal agencies.

It was noted by the Commission that although the impediments to using multiyear contracting should be eased, the concept is not a panacea and should be applied appropriately. We agree. The use of multiyear contracting should be limited to those situations where there is a substantial likelihood of achieving benefits with acceptable risks. Accordingly, management judgment must be exercised to determine the appropriate application of the authority. Standards for exercising such judgment should be reflected either in the legislation authorizing the use of multiyear contracting or in the implementing regulation.

In the last session of Congress, GSA was pleased to support enactment of S. 2300, the Civilian Agency Multiyear Contracting Act of 1984, which ultimately was passed by the Senate. During hearings on the proposed legislation, a substantial record of support for expansion of multiyear contracting authority was

developed. Among those organizations which commented favorably on enactment of S. 2300 were the Office of Federal Procurement Policy, the Chamber of Commerce of the United States, the Computer and Business Equipment Manufacturers Association, the National Academy of Public Administration, and the General Accounting Office. Given the widespread support for the concept of multiyear contracting and for S. 2300, we would strongly urge this Committee to continue its efforts to enact legislation which would permit the civilian agencies to make wider use of multiyear contracting.

Enhancing competition in contracting through the use of functional or performance specifications

The Grace Commission concluded that, by simplifying the procurement process through more extensive use of functional and simplified specifications, the Government could save an estimated \$72 million per year on purchases made by civilian agencies alone. More specifically, the Commission noted a tendency toward complex procurement documents typically describing a needed item in technical terms. For instance, a typewriter ribbon specification would contain nine pages of details, plus a five-page amendment. In contrast, the Commission pointed out that describing that same item in commercial terms using a "commercial item description" would take two-thirds of a single page.

GSA agrees that the appropriate use of simplified specifications, specifically the use of "commercial item descriptions" (CIDs) for commercial products, will benefit the Government procurement



process. We would like to briefly elaborate on our usage of CIDs.

From the earliest development of CIDs, GSA consistently has found that the use of CIDs enhanced competition in contracting. The benefits of using CIDs include 1) open competition by describing end-use products rather than requiring specific manufacturing processes, 2) a broader area of competition even within a given item by removing unnecessarily strict quality level requirements, 3) assistance in eliminating uncontrolled Federal agency open market purchases by providing commercial products, 4) eliminating the need for Government unique items and 5) procurement of quality items at lower cost.

Between 1979 and 1981, GSA developed 898 CIDs. An internal audit of the CIDs program conducted at the end of 1981 showed that the average number of bids per solicitation increased 5 percent, from 4.1 to 4.4, where CIDs were used in lieu of traditional specifications. Dollar savings, however, have been difficult to assess since, by their nature, CIDs require quality commercial products--not necessarily cheaper ones.

There have, of course, been instances cited with significant savings. For example, CIDs have reduced by 20 percent the Government's cost for standard office furniture, saving as much as \$20 million in yearly purchasing costs.

GSA anticipates that the CIDs program will continue to be important to the procurement policies of the agency. Both the Federal Property Management Regulations (FPMR 101-29) and GSA's internal standardization handbook have been revised to include more detailed sections on the development of CIDs and the use of non-government standards. At the same time, as part of the ongoing evolution of the CIDs program, GSA has also discovered that some commodities are not conducive to procurements using CIDs, primarily because of the fluctuations in the commercial market, or the absolute need for a specific quality level. Thus, while the CIDs program is not an appropriate substitute for detailed design-oriented specifications in all cases, GSA will continue to emphasize the use of CIDs to enhance competition in contracting.

Lessening the impact of socio-economic programs on the acquisition process

The Grace Commission concluded that opportunities exist to lower procurement costs by "reforming" those Federal socio-economic programs which are implemented through the procurement process. The Commission's specific recommendations in this area included (1) the initiation of a project to analyze the costs of such programs in relation to the objectives they achieve, and the development of less costly implementation mechanisms; (2) establishing a requirement that future socio-economic program implemented through the procurement process be subjected to a cost/benefit analysis; (3) enactment of legislation raising the

small purchase ceiling to \$25,000 Government-wide; and (4) enactment of legislation tying thresholds for socio-economic programs to the ceiling for small purchases.

GSA generally supports the recommendation of the Commission. Although GSA has a record of significant achievement in promoting socio-economic goals through the procurement process, we believe that cost savings may be achieved without adversely affecting the beneficiaries of such programs. However, we have a number of observations with respect to the specific recommendations. First, there is merit in analyzing existing socio-economic programs and developing less costly and burdensome approaches to their implementation; however, the majority of these programs are statutorily based, and, with few exceptions, Congress has been reluctant to follow-up on those analyses and recommendations which have already been made in this area. For example, the General Accounting Office has, on a number of occasions, reported to Congress concerning the Service Contract Act and the Davis-Bacon Act. To the best of our knowledge, changes to these statutes have not been considered by Congress.

Similarly, although we agree with the sentiment that led the Commission to recommend an Executive Order requiring a cost/benefit analysis before adoption of future socio-economic programs, we believe the recommendation is aimed at the wrong branch of Government.

The vast majority of socio-economic programs which depend on the procurement process are the product of legislation, not administrative action. Accordingly, a cost/benefit analysis by the Executive Branch will have little or no impact on the implementation of the law. To be effective, such an analysis would have to be performed by Congress prior to enactment of socio-economic legislation.

With respect to raising the small purchase ceiling to \$25,000, we note that this has already been accomplished by legislation for both the military and civilian agencies. However, while Congress recognized the need to develop economic and efficient processes for accomplishing low dollar value acquisitions, it must also recognize that the objective is impeded by a variety of statutorily imposed requirements which place procedural burdens on small purchases. Thus, we strongly endorse the Commission's recommendation that the thresholds for such requirements be tied to the small purchase ceiling.

GSA believes that there may be sufficient justification for immediate enactment of such legislation. However, to further substantiate and document that such a change would significantly improve the economy and efficiency of small purchasing, without materially damaging the affected socio-economic programs, GSA, DOD, and NASA have jointly proposed that a test be conducted under the authority of Section 15 of the Office of Federal Procurement Policy Act. This law authorizes the Administrator,

OFPP, to conduct Government-wide studies of ways to improve the Federal procurement process.

Our test proposal was submitted to the Administrator, OFPP, on December 16, 1984. In brief, the proposal would test simplified small purchase procedures by obtaining a limited waiver of ten statutory provisions. The statutes proposed for waiver are ones which did not apply to small purchases at the time of their enactment, but which have subsequently become applicable because their thresholds have not kept pace with later amendments to the small purchase ceiling. In conducting the test, we would monitor the impact of revised small purchase procedures on procurement costs, paperwork burdens, procurement lead time, and small business participation. We would also attempt to identify any significant adverse impact on the beneficiaries of the statutory provisions which are waived.

#### Simplifying the regulatory requirements

The Grace Commission directed its recommendations concerning regulatory constraints to the Department of Defense in order to improve the directive system which governs the acquisitions of weapons systems. Because of its statutory authorities and responsibilities, the General Services Administration also has an interest in providing a regulatory system that provides adequate guidelines for conducting the procurement process, without unduly burdening that process and inhibiting professional judgment. Consequently, we will address the significant themes of the

Commission recommendations without commenting on specific issues affecting DOD.

When the Commission's report was written, the Defense Acquisition Regulation (DAR) was the primary regulatory document which governed procurement by the military services. Subsequently, DOD, GSA, and the National Aeronautics and Space Administration (NASA) jointly issued the Federal Acquisition Regulation (FAR) and are working together to continually update this basic procurement regulation for all Federal Executive departments and agencies.

This new Government-wide procurement regulation addresses many of the problems identified by the Grace Commission in the regulatory area. For example, the FAR establishes a uniform regulatory system for all Executive Branch agencies. The FAR also precludes agency acquisition regulations that unnecessarily repeat, paraphrase, or otherwise restate the FAR. Further, it limits agency acquisition regulations to those necessary to implement FAR policies and procedures within an agency. In sum, such requirements should inhibit the unnecessary proliferation of procurement regulations at all levels.

In developing the FAR, we also directed attention to an important theme of the Grace Commission's recommendations--simplification. The FAR was drafted in such a way as to provide regulatory guidance on the Federal procurement process in clear and



understandable language. We also eliminated unnecessary forms and simplified solicitation provisions and contract clauses. This is a continuing objective for all changes to the FAR.

GSA agrees with the Commission's recommendations in this area and supports the objective of simplifying the procurement process where beneficial. We have, for example, developed a proposal for testing simplified small purchase procedures, as I have discussed previously. If authorized by Congress, we believe the test will identify significant benefits to be derived from reducing the complexity of small purchases.

Another key aspect of the Commission's recommendations in this area was the reduction of administrative and paperwork burdens placed on companies which choose to do business with the Government. We agree with the Commission that such requirements may place a burden on industry, may affect competition, and may increase the cost of procurement. Accordingly, where such requirements are unnecessary or are overly broad, they should be eliminated or more narrowly defined. The Office of Management and Budget currently monitors such requirements imposed by the FAR and agency implementing regulations. OMB has directed agencies to review their requirements, and has established goals for reducing the paperwork burden imposed by such requirements. We are happy to report that GSA was able to reduce the paperwork burdens imposed on industry by its internal directives by 24 percent in fiscal year 1984.

While we support the Commission's general recommendations in this area, we must point out that their accomplishment is not a simple enterprise. It is unlikely that anyone involved in or affected by the Federal procurement process will disagree with the conceptual thrust of the Commission's recommendations to reduce or eliminate unnecessary or undesirable procedural complexity, detailed instructions, and administrative and paperwork burdens. However, it is more than likely that substantial disagreement exists as to whether any given requirement of the procurement process is unnecessary or undesirable. Accordingly, determining which regulatory requirements are appropriate candidates for simplification or elimination may prove to be a difficult task, especially when the requirement is mandated by statute.

On a final note, GSA strongly agrees with the Commission's recommendation that there is a need to develop a highly trained, professional procurement work force. We also agree that as the work force improves, there may be less need for detailed regulatory instructions and more opportunity for the exercise of sound professional judgment. GSA is pursuing this objective through the programs of the Federal Acquisition Institute and its internal career management program.

GSA, through the Federal Acquisition Institute, is developing Government-wide programs to improve classification qualification, certification, staffing, training, and career counseling and

appraisal programs, and attract, motivate and retain a more productive professional procurement work force. Internally, we have also developed career management programs, including intern, career development, and co-operative education programs, designed to attract, develop and retain the high quality personnel required to enhance GSA's procurement capabilities. GSA's internal programs establish common baselines of procurement knowledge and require management to assess the employee's procurement competencies and to determine what experience or training is needed in order for the employee to meet the appropriate baseline level of capability. The success of these programs can be assured through the continued investment of time, management commitment, and resources.

#### Enhancing the role of the Office of Federal Procurement Policy

In its report, the Grace Commission reviewed the role of the Office of Federal Procurement Policy (OFPP) and concluded that a central leadership role was appropriate for that organization.

Congress considered similar issues in 1983 in determining whether to reauthorize OFPP. By enacting Public Law 98-191, Congress concluded that OFPP would: be reauthorized for an additional four years commencing in December 1983; provide a leadership role in Government procurement; be given expanded responsibilities and authorities in certain areas. In our view, this Congressional action was consistent with the Grace Commission recommendation.

Similarly, Public Law 98-191 settled the question of whether the Federal Acquisition Institute (FAI) should remain part of OFPP, an issue also discussed in the Commission's report. The law provided for the transfer of the FAI to GSA, which would act as OFPP's executive agent for the operation of that office. The transfer took place on January 8, 1984. Under OFPP's policy leadership, FAI is currently operating effectively within GSA.

Encouraging implementation of OMB Circular A-76 on contracting out

OMB Circular A-76 outlines both the policies and procedures to be used in determining whether a certain commercial activity should be performed by the Government or private enterprise. A-76 is limited to commercial and industrial activities currently performed by Government employees. The Grace Commission found that A-76 directives were not being implemented effectively for a variety of reasons, including agency perception that the directive has not received consistent support from successive Presidential Administrations or Congress.

This agency strongly supports the goals and the methodology presented by OMB Circular A-76 and the OMB Productivity Improvement Program, announced by the OMB memorandum of September 27, 1984. Within GSA, resources have been designated to implement the program, training has been and is continuing to be provided, and cost studies have been scheduled through Fiscal Year 1988.

We also agree with the Commission's recommendations with regard to the need for complete and accurate studies of the more complex functional areas, while permitting management flexibility as to whether a study is necessary for functions of less than 10 full-time equivalents (FTEs).

GSA has been a leader in the implementation of A-76. Since 1980, we have reviewed over 3,000 positions (FTEs) and conducted 111 cost comparisons. During this time, we achieved approximately \$13 million in annual savings and reduced about 1,100 positions. Over the next five years, we have scheduled reviews of over 400 activities and are projecting reductions of approximately 3,000 positions and \$19 million in annual savings.

This completes my testimony, Mr. Chairman. I would be pleased to answer any questions you may have.

Senator COHEN. Our final witnesses this morning are Jacques Gansler and Norm Augustine, two highly respected defense procurement analysts.

Dr. Gansler is the vice president of the Analytic Sciences Corp. and the author of the book, "The Defense Industry."

And Mr. Augustine is the president of Martin Marietta Denver Aerospace and the author of "Augustine's Laws."

I might add that these books have helped me a good deal to understand the arcane world of defense procurement, even though much of it remains somewhat confusing. Nonetheless, both of your books have been instrumental in at least giving me an elemental grasp of the subject matter.

Dr. Gansler, Mr. Augustine, proceed as you will.

**TESTIMONY OF JACQUES GANSLER, VICE PRESIDENT, THE ANALYTIC SCIENCES CORP.; AND NORMAN R. AUGUSTINE, PRESIDENT, MARTIN MARIETTA DENVER AEROSPACE**

Mr. GANSLER. Senator, what I'd like to do, if I could, is comment mostly on the Grace Commission questions that you asked for and enter for the record the prior testimony that I gave on specifically my own opinions.

Senator COHEN. Fine.

Mr. GANSLER. What I might mention, however, is that, in going through the Grace Commission report in some detail, I was pleased at least to see that they did find that the DOD was among the best managed of the overall Government agencies. And this is a conclusion that, as you know, a lot of other independent studies, like by the GAO and others, have found. DOD, as you know, gets all the attention for their problems, but there are lots of examples that one could point out of far greater overruns in other Government agencies. Nonetheless, it's very clear that there's a lot of room for improvement and that's what we're focusing on today.

I also find that their emphasis on the longer term was the right way to look at the problem. In other words, it's not a simple solution. It's going to take time to do it. And too many people are saying, will we save the billion dollars tomorrow afternoon? And the sort of changes that are required are really in years rather than in weeks or months. And so I think that that perspective needs to be given and it was placed there, although the interpretation of it has gotten quite a bit of emphasis the other way.

I think, overall, their numbers are probably not too unrealistic, that you might be able to get a 10-percent savings at the end of, say, a 3-year period. But not a 10-percent savings in the first 2 years, even. And, again, I think that that's an important effort, and whether or not you realize the full savings that are indicated by those and other recommendations, to me, the effort is more than worth it because we're talking about billions of dollars involved.

Perhaps I might summarize my own reaction to the seven specific questions that you asked and then go to Mr. Augustine.

The first one you asked was the OSD-15 recommendation, the organization of the acquisition function within the DOD. Now here, I believe the Commission did address a critical question. But I feel



that they went too far in their recommendation for consolidation of the management of the acquisition function at the OSD level.

I think in order to address that question, you have to look at what are the causes of the problem, to see whether or not that's the proper recommendation.

I think there are four principal causes of acquisition problems. The first is up in the front end. When you establish the resource planning, the weapons requirements, the selection process, which weapons are going to be bought. That is not a function of the management. That's a function of the selection and requirements process. That's the first of the causes.

The second one is the continuous instability in the budget and requirements process. Those are external to the actual buying process.

The third one is the absence within the process of any natural or market incentives to drive down prices and drive up quality and the move toward dual sourcing, as you noted earlier, is a step in the direction of addressing that issue.

And fourth, the absence of any visibility into the health and responsiveness of the industrial base, the supply side of the military industrial complex.

Now, I'm going to address many of those issues in answering the seven questions. But I should note in much more detail in my prepared testimony that I submitted, as well as, as you noted, the CSIS studies that you were involved with, that Mr. Augustine was and I was, cover these same issues in far more detail.

The reason I feel that the Grace Commission goes too far in its centralization recommendation in terms of essentially a single buying agency is that it doesn't really address those four issues, that the need for, for example, jointness in terms of the requirements process is the issue that requires strengthening of the Chairman of the JCS and the Under Secretary of Policy in OSD, not a single buying agency because that would not address which systems we buy. I also believe that the management of the acquisition function should be decentralized rather than centralized.

Senator COHEN. The Carlucci initiative?

Mr. GANSLER. Yes; in a sense. But, again, I think the Carlucci initiative has been misinterpreted. What I think Frank was trying to get at there is the importance of decentralizing to a program manager. And I'm going to address that in one of the subsequent questions on program management. By giving him more authority, once you've told him what it is that you want him to buy and giving him the money, as contrasted to trying to manage out of some central bureaucracy.

But, on the other hand, the decision process, the decision of which weapons we're going to buy and how much resources we're going to spend, that is a centralized decision process and should not be decentralized to the individual services and then further down.

Basically, the recommendation of decentralizing the management and centralizing the decision process is the way that President Eisenhower actually divided up the responsibility between the centralized OSD-JCS functions and the service functions, and it hasn't fully been implemented.

The second question you asked to address, which was OSD-22 and procurement 8, the strengthening of the cost estimating and scheduling functions. Here, it clearly does need to be strengthened. But, again, I think the critical issue is using the more realistic information rather than actually generating it.

Now, by that I mean the realistic program estimates and the likely future budgets, the combination of these being used in budgeting and long-range planning. Over optimism on either side, either for the program estimates or for the dollars likely to be available, will result in the inefficient stretchouts and the inefficient production rates, the overruns, and so forth, that we've seen.

As you know, the danger here is that it's much more attractive to assume, first, you'll get a lot of money and, second, each program won't cost very much, because that way you can get more programs into the pot.

The inverse is if you are realistic in using the right numbers, there are going to be less programs that are going to get started or that are going to be continued in terms of cancellation. And everybody always hopes that this program will be different, it won't have an overrun and next year we'll get lots of money. So, therefore, let's try to be overly optimistic. And rarely is that the case.

As a complement to that, I might note that I think it is necessary for the DOD to spend some of the resources on doing some basic research on cost estimating and schedule analysis in order to determine the data base and the models on which these realistic costs can be derived.

The third issue you asked me to address was increasing stability. That's OSD-23 and procurement 4.

The issue of stability, in my opinion, is one of the most critical of the DOD needs. The Grace Commission wording there, I think, was exactly appropriate. It says, "Commit to stable 5-year spending plans for weapons systems."

Now this reform, Senator, I believe must begin with the Congress. The United States is one of the few, if not the only nation in the world with a 1-year defense budget. You just can't be efficient under those conditions.

A multiyear defense budget, therefore, is the first step and Congress and their staffs, having established such a multiyear defense budget, have to learn to stick to their prior year commitments. Stop changing every line item essentially annually.

Now, the DOD, then, has to learn, and self-discipline is required here, to develop long-range plans and stick to them. Baselineing, which they're initiating now, is a step in that direction. The \$20 billion for the B1-B is an attempt at moving in that direction. As I say, I think the DOD is starting to go in that way.

In that environment, then, of overall greater stability, combined with the cost reduction initiatives of competition and things like that, then you can take full advantage of the potential savings of multiyear procurement contracts.

So I think multiyear contracting should be set in the context of multiyear budgeting and competition in order to realize the full benefits from it.

Senator COHEN. And if I can take a line from Mr Augustine, maybe multiyear people.

Mr. GANSLER. Yes.

Senator COHEN. He has the wonderful line that the Defense Department is attempting to develop major new systems with a 10-year technology, 8-year programs, 5-year plan, and 3-year people. I think that sort of sums up the dilemma that we see.

Mr. GANSLER. Exactly. In fact, that was the next item you had asked us to address, which is No. 4, strengthening the program manager. That's the procurement 9 issue.

There are two important needs. I think besides just keeping someone longer in his job, the more important issue is to enhance the career opportunities for those people, so you get the best people in those jobs. Having an incompetent in a job longer isn't really a desirable characteristic. And I think the thing that will get the good people in those jobs is the opportunity for promotion. And that is right now not the case.

If these jobs, these program management jobs, become desirable career paths, where the good people want to stay, gain experience, reach the flag and general officer level, then I think you'll have achieved the major step forward that you're looking for.

The second thing that's required for the program managers is to give them the authority. You talked earlier, for example, about tailoring specifications. If they don't have the authority to do that relative to the other groups who are asking for the standard specifications to be applied, then they lose the management authority and giving them all the responsibility and accountability in the world won't do the job.

If he or she can't make these tradeoffs on requirements, specifications, data, changes and so forth, as they impact their costs and schedule, then they really can't manage the program. Again, baselining in this area will help if the services live up to their own internal contracts.

I think the program management authority being increased goes along with the decentralization that I recommended earlier for implementation. Agree to what it is that you want to do and then give the program managers the authority to run their programs within the dollars you've given them and the requirements you've given them.

The fifth area you asked us to address is in enhancing competition. This is OSD-20 and procurement 22.

Here, the need clearly is for the defense world to move toward the creation of some form of continuous alternative for each weapon system, for its subsystems, and also for the critical parts. Again, this is not the case today, although, as you suggested, there is movement in that direction. And I think some of the services have done a very good job, and I agree with your assessment about the Navy moving in that direction.

Single suppliers, however, are still the common situation. Functional specifications, tailored military specs, common parts, such as the Grace Commission suggested, those will help, as will things like design-to-cost and other commercial techniques.

However, the issue is much deeper than that, in my opinion. It really requires more of a cultural change. Essentially, we have to have an acquisition strategy for each program that maintains viable alternatives, so you're not stuck with the single-supplier, no

matter what quality or cost you get. You want to create market forces that will drive down costs and improve quality.

The difference here that I would like to stress that doesn't come out in many of the hearings, frankly, is the difference between competition for an initial award, the so-called auction, or continuous competition, in which you are continuously trying to drive down the costs and drive up the quality. And naturally, that continuous competition, as you properly pointed out, Senator, costs some money up front. But it's well worth, I think, the return that you get for it over the life of the program.

Now I think equally significant is that the Government has to learn to stress competition for higher quality. Now here, it's the total cost, the long-term costs, that matter. And I have the feeling that especially on high technology items, whether they be studies or hardware, that the Government has to learn to distinguish between the best bidder and the cheapest bidder. And that is the process that they're going through now. And the constant emphasis on the lowest possible price on a very high technology item, I don't think is giving the Government the quality that it wants. Competition and quality don't have to be inconsistent; in fact, they can go together. And I think we have to learn to do that.

Senator COHEN. To give you an example, we had a hearing here about 2 or 3 weeks ago in which a major shipbuilder, by competing initially to get the contract, forced the other competitor out. This shipbuilder then went \$140 million higher by the time they negotiated the final price. And so once the competition is gone, the price tends to go up. It's a common practice to come in with the lowest possible price, knowing that either changes are going to be made or that some additional requirements are going to be insisted upon by the Department to give it a better quality.

And that is something that seems to be endemic—not just one shipbuilder, but throughout the entire industry—buying in, with our focus upon the cheapest possible price, without regard to what replacement is going to cost or what repairs are going to be necessary, which ultimately drive the costs way up.

So I agree entirely with you that we focus too much upon the cost item itself, without focusing enough on quality.

Mr. GANSLER. That's also an excellent example, I think, Senator, of the comparison between the sort of one-shot competition for an award versus the alternative of a more continuous competition. I mean, if you compare the shipbuilding example, on most of the ships, historically, in recent years, we've been having these sort of auctions for the award and then from that point on, you're sole-source and you can continue to raise your prices or not have as great a concern over the quality, as contrasted to, say, on the patrol frigate, where there were two sources continuously going along, and the Navy did find that a very steep learning curve was achieved by that presence of continuous competition from the multiple sources. And I think that that is a distinction that also is true in that shipbuilding case.

The sixth one you asked us to address was simplifying the regulatory requirements. That's OSD-17.

Now here, I had the impression, listening over the last hour or so, to the fact that the simplifying of the regulatory requirements



was solely an executive branch responsibility. My perception is that over the past year, there were over 150 bills going through the Congress that would affect the procurement process within the Department of Defense, some in a counterproductive fashion, some very productive, and some, in fact, that were conflicting within themselves.

And I feel that the overall process is, in fact, getting more cumbersome rather than less, from both sides of the street. The spare parts, so-called, reforms that have come along have, in fact, doubled the procurement lead time on logistics items as one of their reactions to the increasing regulation, if you will, in that area.

Norm Augustine has pointed out that the growth in regulations has well matched the rapid growth patterns of a weed. The answer, as I noted above, I think, is to shift the DOD market from a totally regulated, sole-source environment to one of more continuous competition, where natural market forces can essentially replace regulation as the normal control mechanism.

Last, you asked us to address as item 7, enhancing the role of the Office of Federal Procurement Policy, procurement No. 1.

This small organization, which has a professional staff of about 25 people, plays an important function across the overall Federal Government, particularly in the nondefense agencies, I believe. It needs to play an even stronger, more proactive policy role, I think, in the improvements, simplifications, and professionalism in the procurement arena.

I believe it could also serve a very valuable professional and monitoring function on the impact of the many bills that are now being proposed annually by the Congress in the procurement area. The fact that OFPP is essentially an arm of both sides should be, I think, used more by the Congress. You could use them as the experts on these over 100 bills that you're putting through as to what will be their impact, what will be their cost effects, long-term, what will be the contradictions with current laws that are introduced by the laws you're now trying to pass? I'd like to see this latter role considerably expanded for OFPP.

In conclusion, I think there clearly is room for and an urgent need for changes in the way defense business is done. Both the Congress and the DOD are responsible for the problem and they have to therefore implement the necessary actions.

The actions, I believe, fit into four categories—JCS reform, budget reform, procurement reform, and industrial revitalization. These are general categories, but essentially, all of the recommendations that I just went through fit into those. They're all required, and they all have to be initiated now if we're to strengthen the Nation's security and give the taxpayers their money's worth.

Thank you, Senator.

Senator COHEN. Thank you very much, Dr. Gansler. Just one question. It was suggested, perhaps by implication only, but nonetheless, suggested, that because each service has a unique mission, be it the Marine Corps, the Army, the Navy, the Air Force, they automatically or, at least, presumptively, employ a unique method of procurement.

I am just astounded to see the growth in the supplements to the FAR, itself, which was envisioned as somehow simplifying and uni-

fyng the procurement regulations. And yet, we find that the FAR supplements have far exceeded the FAR, itself.

Does it follow because a mission is unique that you therefore have unique procurement requirements?

Mr. GANSLER. I don't believe it has to. And I believe we do far too much of it.

I think that if we move towards more jointness and, clearly, that's the way we fight wars, so it makes sense to do our planning in a more joint fashion, that we will undoubtedly evolve toward more joint weapons systems. That doesn't mean they'll all be joint, but there will be a large number of them. And it's clear that, in many cases, these specifications could be identical. In many other cases, there will be selected differences. The Navy may emphasize salt spray and the Air Force might not have to.

But those are very selected things, as contrasted to the general specifications having to be written in different colors because the four services are different.

I looked last year at managing joint programs and the difficulty of doing it. And, clearly, the different procedures and processes, specifications, regulations, et cetera, within each of the services are a driving factor. Different cultures and backgrounds also drive everything to be different. I mean, we do things differently because "we have always done them differently," as contrasted to "they need to be done differently."

I think one should really shift the question from the present question, which is: why do they have to be different? to asking it in a more positive fashion. And I think we should do it relative to all weapons systems and all specifications.

In other words, let's assume that they're going to be the same, unless you can show why they should be different. And I think you could do that with a weapons system. Why shouldn't this be a joint weapons system? "Prove that it really shouldn't be" should be the question; that it shouldn't be joint. And the same thing with the specifications. Prove that it shouldn't be common.

I think if you ask the question that way, you'll come up with the fact that, sure, there are going to be some differences. But most of the time they should be the same.

Senator COHEN. And you would agree that with respect to GSA, it should be a presumption that, yes, you will purchase common items through GSA, unless you can demonstrate why you shouldn't?

Mr. GANSLER. That would follow in terms of the common items. But, again, I think you have to put that into perspective that you're talking about the thousands of small dollar items. The big thing that impacts the Department of Defense is the major weapons systems. And GSA is not involved in that. I mean, they have their own unique problems. But even on the major weapons systems, specifications could be more common among services.

Senator COHEN. Thank you very much. Mr. Augustine, I'm not sure that you've been elevated to sainthood, but "Augustine's Laws" has received wide readership. Certainly here on the Hill, as well as throughout the country.

Would you proceed?



Mr. AUGUSTINE. Thank you, and good morning. Mr. Chairman, with the committee's permission, I'd like to submit the formal statement I provided for the record and just summarize some of my thoughts this morning.

I should first of all say that my perspective is one drawn from a number of years in the Government and also a number of years in industry, although I certainly wouldn't presume to speak for either of those institutions this morning. My comments will be entirely my own.

You had asked that we address seven particular issues raised in the President's Private Sector Survey on Cost Control. To do that, I would like to treat them in four different groupings, a little different from the ones that Dr. Gansler happened to have chosen, but still four groupings.

When one views defense procurement from the standpoint of the private sector, and particularly the conventional commercial sector, I think it's important that one recognize that there are distinctions that make it difficult to transpose policies from the commercial sector into the Government defense procurement area.

First of all, we're dealing with what is basically a monopsony in this area. Second, after an initial, usually very intense, period of competition for programs in the Defense Department, the contractor frequently finds itself in a position approaching a monopoly.

Third, the programs that the Defense Department pursues are so large that they eclipse most things considered in private development. It's not at all uncommon for companies to pursue single programs on behalf of the Defense Department that are many times the net worth of the company itself.

Finally, the programs that are pursued are the type whose outcome could affect the very basic survival of our country. So success is of the utmost importance in the aggregate for those programs.

Let me turn to the four areas that I would like to discuss. They concern centralization, cost estimating, turbulence, and competition.

Beginning with the issue of centralization, I would suspect that the reason that we've seen a tendency toward more and more centralization in Government procurement is an effort to avoid repetition of the problems that have been encountered in the past. Unfortunately, though, our policies that have stemmed from that well-meaning intention have been so constraining as to make it very difficult to enjoy successes in the future.

We have, in effect, placed our managers in a position where they have very little latitude to manage, whether they be Government managers or industrial managers.

I believe that there is one reasonable parallel that one can draw between industry and Government in terms of how the acquisition process might best be managed. I would say, for example, that the role of the Congress, insofar as it relates to procurement only, could closely parallel the role of the board of directors of a large corporation. I think the role of the Office of the Secretary of Defense could best parallel the role of a corporate staff in a well-managed corporation.

I would think that the role of the services is more akin to the role of an operating division in industry. And each of those is a

very distinct function. When one tries to do the other's job in industry, one becomes very noncompetitive. With all due respect, I would suggest that no industrial firm could survive in the private sector using the policies that the Government uses today in terms of who is responsible for what.

The Joint Chiefs of Staff also play—or could play—a more important role in the procurement area, particularly with regard to the establishment of requirements and resolving issues that cut across the services.

Dr. Gansler points out the services do not fight battles individually they fight the enemy jointly.

Similarly, technology does not respect service boundaries. It cuts across boundaries. So one needs a militarily qualified organization to be able to resolve the issues that naturally cut across service boundaries. To do that, a number of suggestions have been made. I would certainly subscribe to placing the Chairman of the JCS as an individual in the chain of command, and giving the Chairman a four-star deputy to ease his burden. Having done those things, one could reduce the consensus requirement that now exists among the four chiefs in order for the JCS to take a firm position.

Senator COHEN. Can I interrupt you here?

Mr. AUGUSTINE. Please.

Senator COHEN. Are you suggesting that you really can't have this kind of procurement reform by having more consolidation until you actually break down the separation of the service chiefs, as such, to have a more common pursuit?

In other words, you can't change procurement without changing the structure of the military leadership because each is going to protect its own unique turf—Marine Corps versus Air Force versus Army. Each has devised, by custom or habit, a whole mindset that they are unique and therefore, can't have this kind of sharing operation.

So what you've got to do to have effective procurement reform is to have effective structural reform on the military side.

Is that essentially it, you can't have one without the other, or it won't be as effective?

Mr. AUGUSTINE. Having served both in the Office of the Secretary of Defense and with a service, I would say that it's more a matter of dealing with the perspectives that come from being in one of those positions, than trying to protect turf in those positions.

The fact remains that, at the policy level, we need people who have very broad boundaries and can cut across all the issues at hand.

While I wouldn't say that one can't have procurement reform without strengthening the role of the Chairman of the JCS, for example, to get the full benefit of procurement reform, I really do think that that is useful.

Many of the problems in the procurement system are in the requirements area. It's very difficult for civilians in the Office of the Secretary of Defense to render the kind of judgments needed. The JCS has to stand up and be counted on tough issues that cut across service bounds.

To do that, I think we need a joint staff that reports to the Chairman. We need a Chairman who is in the chain of command, and so on.

Mr. GANSLER. Senator, if I might comment.

Senator COHEN. I mention this because I think the study that was done by the Center for Strategic International Studies [CSIS] really ought to be looked at very carefully and thoughtfully, not only by the Congress and the Defense Department, and the President, but also by the country, itself. What you're saying is, I think, terribly important about the need for reform across the board, not just one element of it.

Congress has to reform its buying ways, and its budget ways. The Defense Department has to be reorganized, the whole process across the board, from military, JCS, budget, multiyear buying, multiyear budget, and so forth. I think that's a terribly important study. It's going to be resisted. It already is being resisted, I might add.

But if we're really talking about how to achieve a better government at a better price, then we ought to look very carefully at what you gentleman have had a role in trying to shape.

Mr. GANSLER. I was going to say that all the classic studies of how to change performance have said that if you just try to address it right at the performance level, you get sort of microadjustments. If you really want to change performance, you change the structure, which changes the conduct, which then changes the performance.

And I think in terms of priorities, there's no question in my mind, at least, that you're going to have small adjustments if you address the procurement process without having looked at the two driving factors, which, as Norm said is, first, the requirements side, the front end—if you select the wrong systems, what difference does it make if you buy them well.

I mean, you want to select the right systems.

And then the second one is if you can't control the budget process in terms of stability, there's no way that you're going to achieve efficiency.

So the changes in the structure at the jointness level, and that's where the JCS reform comes in, and at the budget level, in terms of stability, have the priorities relative to the microadjustments at the procurement level. Then you can make the procurement adjustments.

Senator COHEN. Let me come back, Norm, to this element here, which I think is perhaps the most troublesome.

The Grace Commission looked at the problem we've got with cost escalation and they've concluded that you've got a fusion of the research and development along with the procurement and production process. They ought to break those up in order to prevent what you refer to as "requirements creep."

We have a fundamental problem here. We have always maintained in this country that our technology is what gives us our equivalency with the Soviet Union, not superiority. We can only maintain that edge provided we constantly expand the envelope of technology.

And what we have is a situation in which those at the requirements level are constantly updating. You know, you've got to have a system—well, it's air-to-air, air-to-ground, all-weather, lookdown, shoot-down capabilities, and it keeps getting more and more sophisticated. And I think you, yourself, have pointed out that if we continue our ways, by the year 2020 it will take the entire defense budget to buy one aircraft, given the way in which we are escalating those costs.

How do we deal with the problem of trying to keep up with technology, take the best that we can and, on the other hand, settle for something that is durable, perhaps not as sophisticated, but still does the job?

It's a continuing debate within the military community. Do you go for the more sophisticated, the best that we can get? And if you do, are you going to get fewer of them? We're up against an adversary that simply doesn't have that kind of restriction.

And it's been pointed out, after a while, quantity has a quality of its own. They're building an F-15 which one on one, can probably take anything. One on two can probably still prevail. One on three, it becomes a bit dicier. One on four, you've got real problems.

So how do we deal with this problem of trying to always take advantage of improvements in technology, which come by the day and, at the same time, continue with the program.

Now is the same rule going to apply to the Defense Department? Here's an airplane or here's a ship. Don't change it. Here's what we're going to build over the next 5 years and there won't be any changes.

Can we really do that?

Mr. AUGUSTINE. I think to a very large degree we can and should. I think instability of requirements that you point to is one of the major contributors to increased cost. I see no reason, in general, although I'm sure there are exceptions, why you can't fix the characteristics of an end item and build it. Importantly, one must provide at the outset for upgrading later on.

I believe that's one of the areas where we can make major savings, called P cubed I—preplanned product improvement. Rather than abandoning an item in which one has a major capital investment and going to an all new item, one can introduce new technology in packages into that item and prolong its lifetime.

Of course that's done to some degree today, and I think it could be done to a still greater degree and help a great deal.

Mr. GANSLER. Senator, if I might, in addition to the use of the modifications for continuous updating of the systems, which I completely support, it seems to me that there are two other considerations that relate to the issue you've raised.

One is that people tend to use technology, I think not necessarily in the most advantageous fashion. In fact, even sometimes you hear reform groups arguing that you have a choice between technology and low cost.

Well, I think that's exactly the wrong alternative to present. What you should view technology for is the opportunity to provide lower cost and higher quality. That is, in fact, what the commercial world uses technology for.



So you're continuously improving performance while, at the same time, getting higher quality and lower costs out of the advanced technology.

In the commercial world, that's referred to as design-to-cost. And so you want to take the technology design of, say, the next generation fighter plane to be a lower cost, higher quality, better performing aircraft, but you don't get the last 3 percent of performance at, say, doubling the cost.

That's the part that you have to avoid.

Senator COHEN. But it's just the reverse from what we're doing now, is it not?

Mr. GANSLER. I believe that we're pushing technology to give maximum performance and then trying to find out whether you can get somebody to bid low. That's different than using technology to design a lower cost system, which is inherent in the technology, and higher quality is inherent in the technology. But if you're going to push it to the very edge of the state of the art to get the last 2 or 3 percent of performance, then you are going to make a significant increase in the cost and you're probably going to make a significant reduction in the quality of the system in terms of its reliability. And Norm has pointed that out in his book in terms of projections of curves.

The other thing that I think would help a great deal is, instead of saying we're going to pick this system by this contractor and freeze it, that from that point on, you have then eliminated competition or alternatives for that one. You then generated perverse incentives—incentives to raise the cost—and, in fact, they even have the quality low, so you can sell more spare parts.

So that what you really want is the inverse. You want some way of keeping an alternative.

Now it could be that one alternative is the next generation's system that's being developed to compete with that current system. It could be another way of doing the same job. Say, for example, competing F-14's against F-18's, as Secretary Lehman did recently.

It doesn't have to continue with dual sourcing. But some way of keeping that alternative present so that you have a natural tendency to take advantage of the new technology to drive down costs and raise quality, rather than saying, "I've got the only contract and I know that they'd rather have higher performance. So I'll keep putting in new changes and it will give me higher and higher performance, but, by the way, it raises the cost."

Mr. AUGUSTINE. I'll continue, then, with the final three areas I want to discuss.

The first concerns cost estimating. Certainly, the estimation of cost in initial production of high technology items, as well as in research development, has uncertainty. There is risk. There are unknowns. That's true almost by definition because you're doing something that's never been done before.

In the case of my own company, we have a recognized process whereby we make three cost estimates, not one, as does the Government in its analyses. We make an estimate that there's a 20-percent probability that we'll do better than that. We make one estimate for which it's a 50-50 probability that we'll come in above

or below. And we make one estimate at which we're 80 percent confident that we can do the job.

Given those three numbers, one can get a much better idea of what kinds of uncertainty one is dealing with, how one should budget, and what the risks are. In order to get those numbers, you have to identify where the risks are, and that's very valuable in risk management.

Importantly, having obtained an idea of the uncertainty, one has to make provision for that in the budgeting process. All too often, our budgets leave absolutely no margin for the uncertain or the unknown to occur. Yet the unknown does occur, even in the very best managed programs, in the high tech area.

The Army has a system called TRACE, for total risk assessing cost estimate, which does make provision for an uncertainty, and the Congress has supported the Army. By providing for the accommodation of uncertainty in the budget process, I think we save a great deal of money, and we most certainly get better cost estimates on which to base decisions whether to start programs or not.

The same is true of schedule. We have to account for uncertainty and how long it will take to accomplish some given task, because without that uncertainty, we will almost invariably continue to have overruns in time as well as money.

As one of the laws in my book, which you mentioned, says, if we don't adopt this recognition of risk and uncertainty, the only alternative is to, "Never promise to complete anything within 6 months of the end of the year. In either direction." [Laughter.]

The third thing I would like to talk about is turbulence. Continual changes of people, of funding, of requirements, of schedules, of budgets and so on, are very counterproductive. They demotivate workers. They distract management's attention from doing the job. They discourage corporations from investing to be more productive, and they absorb a great deal of time of those in the Government who must manage programs.

Multiyear contracting, I think, is a fine step, when used selectively. Although I personally think that its value has been overstated a bit, for reasons I'd be glad to elaborate on if you wish, I think it is a useful first step. A far more valuable step would be to go to a multiyear budget; at least a 2-year budget. I think that would free the Congress from the incredible burden that it bears, and I believe would add more efficiency to industry than any other single thing that I can think of, other than possibly this provision for uncertainty in cost estimating.

The final thing with which I would like to deal is the matter of competition. Competition is probably the most powerful tool that the Government has to provide incentives to contractors to behave as the Government wishes.

In that regard, the use of past performance in future source selections is a very powerful tool that only recently has begun to be embraced by the Government. We're seeing more of it.

Unfortunately, it's used terribly inconsistently—almost unfairly at this point. But the basic idea, if done right, will be a great incentive to companies to do a good job, because those that do will be rewarded and those that don't will be "rewarded" too.



Senator COHEN. Let me just point out that I've had some experience with this where a contractor has provided an item to the Government for the last 2 years at a good price. It's gone out to bid and somebody who has just opened up a shop who has two people in it has come out with a low bid and they've got a contract, with no prior experience, no indication whatsoever that they can fulfill the contract. Yet, they've got it now.

And that's, I think, one recommendation that would be very important, if you do have someone with a good prior record and in comes a new contractor setting up shop. Just because they've got the lowest price doesn't mean that we're going to get the best deal.

Mr. GANSLER. Particularly if that second one that just was set up now becomes the only one in the industry. And that was the reason I felt that one of the important steps that is needed to be taken is getting additional visibility into the number of suppliers you have in the different sectors. It is frequently the case that by just going out to this new place that just set up this business, you've now wiped out the one that was in the business for many years.

Mr. AUGUSTINE. That's a good example of the inequity in the current application of basically a good idea. Another would be a situation in which one contractor may have a generally good overall record. A competitor may have a good record with that specific buying element, but have a very bad record with another service or another buying element. But on that instant contract, the buying agency will say, "well, they're doing fine by me. I don't care how they're doing for those other folks."

One needs, I think, a more global perspective of whether the contractor is doing a good job or a poor job, and to treat them accordingly. There are times, of course, when competition can be counterproductive. We often hear of the campaign for competition at any cost—and it can be costly if not used properly.

For example, one contractor may have a great deal of knowledge about how to build a given item. Another contractor may not. We find it very difficult to move an item from one plant to another plant within our own company and still build it efficiently. To move from one contractor to another is very difficult indeed. It can be done, and it is done, but it's not trivial.

Similarly, if one is buying an item for which the run-out production is small compared with the investment cost in putting the second producer into business, it's obviously not a good trade. My own rule of thumb has been that if the second producer can't be put in business for less than a third of his total expected recurring cost, then it's probably not a good buy to put a second producer in business. That's simple arithmetic. It comes out of the fact that competition usually reduces the price by perhaps 25 percent, at least according to the data I've collected.

Mr. Chairman, that's a summary of my general comments on your questions. I'd be happy to deal with specific questions on any of them, should you wish.

Senator COHEN. Thank you very much, Mr. Augustine. I don't think that it will be necessary to ask you any further questions. I think you've covered them mostly in your prepared statement. And I know from personal experience that you covered most of my questions in the CSIS study.

I'm just hoping that the media will focus upon the CSIS study. I want to commend those who have stayed throughout this hearing, including C Span, that is covering it. Perhaps nothing is duller than trying to work one's way through procurement reform and all of the conflicting regulations and problems that we have. And yet nothing is more important.

It seems to me that it is at the heart of our national security. To the extent that the public becomes disenchanted with story after story about abuses, about waste, about fraud, and find that we're now contemplating freezing social programs while at the same time talking about continuing to increase defense spending, they see a basic inequity in that particular formula and have less and less support for a strong national defense.

And so it strikes at the core of defending this country's interests if we don't have a credible and responsible procurement system to spend the billions and billions of dollars to secure our Nation.

So I think it's a rather tedious subject matter to constantly talk about, but I think it's got to be focused upon. I'm hoping that the media, indeed, will focus upon the CSIS study, its recommendations, and have a full and open debate before as many forums as we possibly can.

There is a fundamental perception that we are not doing business in the proper way. When you compare your private experience with what we're doing in Government, there's a basic difference. The Government has operated on the premise that there's no bottom line. Every single business executive, Mr. Bolduc and all the others, always conduct their daily lives, and you do now, Mr. Augustine, on the basis that you've got a bottom line to meet.

With respect to the Federal Government, there is no bottom line. If a cost goes over, well, we'll come back to the Congress for a supplement to pay for those mistakes that we made during the past year. I can tell you of one experience where I went out to visit a plant that was producing a missile system and they made a \$200 million mistake. Call it mismanagement.

Now what do you do in the private sector when you have mismanagement? You probably go bankrupt. Or you certainly have to go to your stockholders for some sort of an accounting.

What did we do? We picked up the cost by simply reducing the amount of the purchase. We didn't buy as many missiles. We bought fewer of them. And that is part of the problem that we're facing today. We're spending more and more and getting less and less. And I think that that's something both of you focus very critically on in your book.

So we've got to change the way in which we're doing business if we're going to maintain public support for a strong national defense and if, in fact, we're going to have a strong national defense.

I think it's terribly important, and I hope that your recommendations get wide circulation.

Thank you both for coming.

Mr. GANSLER. Thank you.

Mr. AUGUSTINE. Thank you, Mr. Chairman.

[The prepared statements of Mr. Gansler and Mr. Augustine follow:]

ENHANCING THE DOD ACQUISITION PROCESS

Testimony before the Senate Government Affairs Committee's Subcommittee on Oversight of Government Management

Dr. Jacques S. Gansler

January 23, 1985  
Washington, DC

I welcome this opportunity to discuss the areas for potential procurement improvements within the Department of Defense -- both as presented in the Grace Commission's findings and in my own investigations. Recently I appeared before the Senate Armed Services Committee's Special Hearings on Defense Procurement, and -- with the Chairman's concurrence -- I would like to have my summary remarks from that session included in the record, so that I do not have to repeat them here.

My recommendations (contained therein) are generally consistent with the Grace Commission's findings, and I believe the Commission is to be commended for its outstanding contribution. It's important to note that their findings again confirm that the DoD is among the best managed of the many government agencies (a conclusion of numerous independent studies -- including by the GAO. Although DoD gets the most attention for these problems, a comparison with the cost and schedule overruns on non-military projects such as METRO, GAO's own computer systems, or the Rayburn and Hart Office Buildings clearly demonstrates that others have the problem). Also, the Commission observed that the proposed procurement improvements will be extremely difficult to implement, and will take a number of years to become effective. There are no quick and easy solutions! Finally, their assessment of the magnitude of the potential cost impact -- perhaps up to 10 to 15 percent of the procurement dollars, after 3 years -- seems attainable and well worth the effort (given the billions of dollars involved), even if all of the potential savings are not realized.

Turning now to briefly address the requested seven specific Grace Commission recommendations:

1.) The organization of the acquisition function within the DoD (OSD 15): Here I believe the Commission properly addressed a critical issue, but I do not go as far as they do in their recommendation for consolidating the management of the weapon acquisition function at the OSD level. In my opinion, the principal causes of acquisition problems in the DoD are: 1) the resource-planning, weapons-requirements and selection process, 2) the continuous instability of budgets and "requirements," 3) the absence of natural (market) incentives to drive down prices and drive up quality, and 4) the absence of visibility into the health and responsiveness of the industrial base (the supply side of an efficient and effective "military-industrial complex"). Many of these issues will be covered in the discussion below. They are also expanded upon in the attached prior testimony, as well as (in far greater detail) in the forthcoming Defense Organization Project report. This effort was done under the auspices of the Center for Strategic and International Studies at Georgetown University and it should be noted that the Chairman, Mr. Augustine, and myself all took part, along with a large, bipartisan group of people from all sides of the defense arena.

The Grace Commission recommendation (essentially for a single buying agency for the DoD) goes too far with centralization, and is not needed to address the four critical issues I just noted. Rather, centralization of the policy/planning/requirements/weapon-selection process is required -- to tie strategy to resources, to select the most cost effective and affordable systems, to get the quantities of systems needed, and to take into consideration that wars will be fought

jointly (not by the military services separately). This requires strengthening of the Chairman of the JCS and the Undersecretary for Policy in OSD. Then, I believe, the management of the acquisition function should be decentralized to the services (covered below in item #4) -- with acquisition policy and oversight (of policy implementation) in OSD. This is basically the division of responsibility recommended by President Eisenhower in 1958 -- but never fully implemented.

2.) Strengthen Cost Estimating and Scheduling functions (OSD 22, PROC 8): This area does need to be strengthened, but the critical issue is the use of realistic program costs and likely available future budgets in budgeting and long range planning. Over-optimism in either area is catastrophic and leads to the historical problems of overruns, inefficient stretchouts, inefficient production rates, etc. In many cases we can estimate the likely program costs or future budget levels, but they are not "attractive" -- and would mean some programs could not be afforded and/or some would have to be cancelled. So we use optimistic numbers, and hope that "this time things will work out differently" -- and they rarely do.

As a complement to the greater application of realistic cost and schedule estimates, the DoD must fund the necessary basic research to develop the models and historical data bases on which these estimates are founded.

3.) Increasing Stability (OSD 23, PROC 4): This is one of the most critical needs in defense procurement, and the Grace Commission wording is appropriate, i.e., "commit to stable five-year spending plans for weapon systems." This reform must begin with the Congress. The U.S. is one of the few, if not the only, nation with a one-year defense budget. You can never achieve efficiency that way! A multiyear



defense budget is the first step; then Congress (and their staffs) must learn to stick to their prior year commitments, and stop changing almost every line item annually. The DoD similarly must develop long-range plans and stick to them ("baselining," as with the \$20 billion for 100 B-1Bs, will help considerably -- and the DoD has begun to move in this direction). Then, in this environment of overall greater stability, combined with the cost-reduction incentives of market forces (discussed under item #5), the DoD can take full advantage of the potential savings offered by multiyear procurement contracts.

4.) Strengthen the Program Manager (PROC 9): There are two important needs here. First, to enhance the career opportunities of people in the DoD acquisition area -- especially their opportunities for promotion. If this becomes a desirable career area, where good people want to stay, gain experience and reach flag and general officer level, then a major step forward will have been achieved. (It is not now the case.) Second, the program manager must be given the authority -- to go with his responsibility and accountability. If he or she cannot make trade-offs on requirements, specifications, data, changes, etc. against their cost and schedule impacts, then the program manager cannot run the program (again, "baselining" will help in this area -- if the Services live up to their "internal contracts"). This change -- to greater Program Manager authority -- goes along with the above-noted move toward greater decentralization of implementation in the management of DoD programs. Agree first to what it is you want, and are willing to spend -- then let the program managers run their own programs!

5.) Enhancing competition (OSD 20, PROC 22): Here the need is for the defense world to move toward the creation of

some form of continuous alternative for each weapon system, subsystem and critical part. Again, this is not the case today; single suppliers (the winners of an initial development competition) are the common situation. Functional specifications, "tailored" military standards and common parts -- as recommended by the Grace Commission -- will help, as will design-to-cost and other commercial-like techniques, but the issue goes much deeper. It requires more of a "cultural change" (as discussed under item #6). Essentially we must have an acquisition strategy for each program that maintains viable alternatives, so that market forces are at work that utilize natural incentives to drive down costs and improve quality. The difference between "competition for an initial award" and "continuous competition" is critical here. The latter always costs a small amount of additional money up front, but the savings over the life of the program are often very significant.

Equally significant is the government's need to stress competition for higher quality. It is the total -- long-term -- costs that really matter; especially on high-technology items (from studies through hardware). The government must learn how to make competitive awards to "the best" bidder, not "the cheapest."

As a complement to this increased emphasis on quality and competition, we need to provide visibility into the health of the industrial base (at all critical levels) to assure its competitiveness, stability, inventiveness and responsiveness.

6.) Simplify the regulatory requirements (OSD 17): Last year, Congress had over 150 new bills that would affect the DoD procurement process. The spare parts "reforms" alone have doubled the procurement lead-times on logistics items. As

Norm Augustine has pointed out, the growth in regulations has well matched the rapid growth pattern of a weed. The answer (as I noted above) is to shift the DoD market from a totally-regulated, sole-source environment to one of continuous competition -- where natural market forces can replace regulation as the "normal" control mechanism.

7.) Enhancing the role of the Office of Federal Procurement Policy (PROC 1): This small organization (a professional staff of 25) plays an important function across the overall federal government -- particularly in the non-defense agencies. It needs to play an even stronger, more proactive, policy role in improvements, simplifications, and professionalism in the procurement arena. It could also serve a valuable professional and monitoring function on the impact of the many (often conflicting) bills proposed by the Congress in the procurement area. I'd like to see this latter role considerably expanded.

In conclusion, there is clearly room for, and an urgent need for, changes in the way defense business is done. Both Congress and the DoD are responsible for the problems, and must implement the necessary action. These fit into four categories: JCS reform, budget reform, procurement reform, and industrial revitalization. All four are required -- and must be initiated now, if we are to strengthen the nation's security and give the taxpayers their money's worth.

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Getting More for Our Defense Dollars

Testimony before the Senate Armed Services Committee's  
Special Hearings on Defense Procurement

Dr. Jacques S. Gansler

September 20, 1984  
Washington, D.C.

Sept. 20, 1984

Getting More for Our Defense Dollars

Jacques S. Gansler

Headlined news accounts of overcharging for spare parts have led to widespread demands for improved management of defense procurement. Congress has responded with a profusion of new legislative "fixes," as well as more and more detailed and frequent, dollar-by-dollar reviews of each and every defense budget line item. However, excessive attention to the costs of wrenches and plastic stool caps will not solve the multibillion dollar problem of increasing defense costs nor provide the needed enhancement of our national security posture intended by the larger defense budgets. Much broader changes are required in the way Defense does its business. Without basic organizational and procedural changes -- in the military, the Office of the Secretary of Defense, the Congress and the defense industry -- the problems are likely to increase; with the detailed, micromanagement by Congress -- fueled by growing public frustration -- only serving to make matters that much worse.

Four adverse trends need to be addressed if we are to simultaneously "get our money's worth," strengthen our national security and develop public confidence in the DoD: 1) Increasing concern that "the system" does not result in the selection, development and procurement of the most cost-effective weapons (for example, the continuing debate over the priority of the \$40 billion dollars for the 100 B-1s and 100 MXs); 2) the continuing cost growth of



individual defense equipment (and the resultant reduced quantities); coupled with, 3) the lengthening acquisition cycle (so that new systems often take 12 to 15 years to get into the field); and finally, 4) the growing problems in the defense industrial base (both in terms of economic efficiency and surge responsiveness).

Reversing these trends will be neither easy nor fast. The complexity and magnitude of the defense acquisition system doesn't lend itself to simple solutions. Additionally, the changes must be such that they do not destroy the current, constructive acquisition practices of the DoD -- generally acknowledged to be one of the best managed of all the government agencies. (A comparison of DoD overruns with those on the Rayburn House Office Building, or the Hart Senate Building, or almost any other large government program, makes this case quite clearly -- as have numerous, detailed analyses.) Nonetheless, there is little question that there is much room for improvement, and if we are to get the maximum military capability for the increased defense dollars, the need for such improvements becomes urgent and mandatory.

Change must begin with the recognition that two overriding issues control defense procurement costs: first, which weapons are bought and how many of them (more nuclear ships or more tanks, more intercontinental missiles or more antitank missiles) -- such choices not only dictate current resource levels and allocations, but also our national security posture into the 21st century; and, second, how we budget and buy these multibillion dollar weapon systems -- in an efficient, stable fashion or with continuous instability and uncertainty.

Presently, weapons are selected and budgeted solely by the separate military Services. The Army, Navy, Air Force, and Marines each choose the systems that appear best suited for their unique historical missions. The Services design their force structures as if they intend to fight independent land, sea, air, and amphibious wars. (For example, in Grenada the different radios of the Services prohibited their direct communication during the conflict.) Future battles will be fought with integrated forces, so weapons and force structures should be selected to complement one another and maximize the combined capabilities of the armed forces.

Unfortunately, those who have the responsibility for planning how wars will be fought -- the Chairman of the Joint Chiefs of Staff and the Commanders of the Unified and Specified Commands (CINCs) -- have little involvement in the defense budget process or in the weapon requirements and selection process. Thus, the responsibility for imposing some coherence upon the uncoordinated budgets and procurement programs of the individual Services has been assumed by the Office of the Secretary of Defense -- with frequent "help" by the Congress. Instead, the people responsible for planning for war must be given a greater voice in determining overall military resource distributions, weapon requirements and system selections. The Chairman of the Joint Chiefs of Staff should be made responsible for developing a long-range, integrated, defense resource plan -- with appropriate guidance and oversight from the Secretary of Defense, and with the assistance of the CINCs, the Services, and the defense agencies. Such a plan would

tie weapon decisions to military strategy and help direct defense resources toward the most effective systems and force structures. The Services would then have full (and unambiguous) responsibility for organizing, training, equipping and supporting the forces. To implement this change, the staff of the Chairman of the Joint Chiefs would have to assume a role more independent of the Services (as President Eisenhower recommended in 1958), and the Office of the Secretary of Defense could return to its proper emphasis on policy and oversight.

The second broad change required to achieve the full benefit from our defense dollars is to introduce year-to-year stability into the defense budgeting process. The United States is one of the few nations in the world (if not the only one) to run its defense establishment on an annual budget cycle. Single-year defense budgets encourage the Services and the Congressional committees to seek annual reductions by "stretching out" procurement buys over several years. This shortsighted measure causes expensive program disruptions and forces contractors to produce equipment at inefficient rates of production -- thus causing higher unit costs and the procurement of fewer systems. For example, the three-year production "stretch-out" of the F-15 aircraft resulted in a \$2 billion increase in program costs. Eighty-three fewer aircraft were purchased than what would have been possible with the dollars actually spent.

Congress could make an important contribution to controlling procurement costs by adopting multi-year defense budgeting. Two- or three-year budget cycles would introduce the stability necessary

for contractors to plan more efficient production runs and lower unit costs of procured systems. Furthermore, multi-year budgets would encourage the DoD and the Congress to consider the long-term, strategic implications of budget and procurement decisions. (Simply making the two outyears of the concurrent budget resolution binding -- as "nominals," with alternatives allowed for Presidential or committee submittals -- would introduce a major element in the required stability.)

The other necessary Congressional change in the defense budget process is to reduce the number of committees involved (and/or hold concurrent hearings). In 1983, Defense Department witnesses testified on the 1984 budget before 96 committees and subcommittees; 1,306 witnesses provided 2,160 hours of testimony. These redundant hearings are time-consuming (for both Defense management and for the Congress) and focus all of the attention on the infinite detail of the budget, rather than on the policy and oversight required. They also introduce incredible instability, and its resultant uncertainty. It has been estimated that savings of 20 percent could be achieved -- after a few years time -- by stabilizing the Department of Defense budget.

Additionally, the Defense Department itself can achieve greater budget stability through establishing realistic total program budgets and living with them. (For example, the Air Force is now trying to discipline itself to operate within the \$20.5 billion figure for the 100 B-1B aircraft.) The result of this discipline would be fewer programs, but each funded program would be far more efficiently run and a great deal more equipment would be procured for the same dollars.

These fundamental changes -- first, improved weapon selection and resource planning and, second, greater defense budget and program stability -- are the essential elements of any reform in the defense acquisition process. However, to be fully effective, two additional areas must be addressed. First, procurement changes that emphasize techniques -- incentives -- that encourage lower-cost weapon systems. Some specific suggestions here are: 1) enhanced government acquisition-management career paths; 2) reduced program risks and schedules through separate development and testing of advanced subsystems (the weapon system modification approach); 3) greater presence (and funding) of continuous alternatives (including more competitive dual-sourcing); 4) a shift in profit policy towards awards (in future years' contracts) for lower actual cost achievements on prior contracts; 5) allowing the Service and the specific program manager to keep and use (either for greater quantities or improved performance) any money saved (instead of losing it, as is now the case); 6) greater DoD use of "baselining" (internal, high-level "contracts" -- between Service management and the program office -- on performance, annual budgets, quantities, total dollars, schedules, etc.) to provide program long-term stability; 7) "hedged" funding for development and demonstration of non-traditional use of new technology to improve military effectiveness (especially when the application cuts across historical Service roles and missions, and thus would have great resistance to funding); and 8) greater use of "design-to-cost" techniques (wherein the last few percent of extra performance is traded off for higher reliability and much lower

unit costs -- so that the number of units can be much greater, for the same dollars).

Implementation of procurement changes such as these will make a major difference in the way Defense business is done. It will shift the management emphasis from regulation to natural incentives e.g., competition, profit, promotion and accountability. It is believed that these can be far more effective.

The fourth of the broad changes required to improve the efficiency and effectiveness of the Defense acquisition process is that of raising the DoD's visibility into the health and responsiveness of the industrial base. The U.S. is the only nation in the world which does not treat its defense industry as a vital national resource. If this perspective is taken, then for each critical sector of the industry visibility would be provided into such conditions as: competitive market forces, labor stability, bottlenecks, viability of the lower-tiers, capital investments, foreign dependency, long-term R&D, capacity utilization, surge capability, and integration of civil and military production.

As a complement to this visibility, the U.S. should better integrate its industrial preparedness and responsiveness capability into its national security strategy. This would provide our nuclear and conventional force posture with a third leg (an industrial surge capability) -- one in which the U.S. clearly has greater potential than the Soviet Union, and one that is of growing importance in an age of nuclear parity.



In conclusion, it again must be emphasized that it will take time and a great deal of effort to make these necessary changes. There are no quick and easy fixes! Today, many on Capitol Hill and the Pentagon are attempting to achieve acquisition reform in a piecemeal fashion -- from spare parts regulation and "programs," through a growing number of detailed procurement laws and regulations. Often such measures are desirable (although their implementation is frequently counterproductive), but they obscure the requirement for fundamental change in the way Defense does its business. If the four broad thrusts described herein are accepted and implemented -- we might term them: "JCS reform," "budget reform," "procurement reform" and "industrial revitalization" -- the combined effect of these will, over time, result in the needed improvements in the Defense acquisition process and they will simultaneously enhance the credibility -- with both the Congress and the public -- of DoD management. Our nation's security requires these changes and the taxpayers deserve them.

IMPROVEMENTS TO THE FEDERAL PROCUREMENT SYSTEM

STATEMENT BY

NORMAN R. AUGUSTINE

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF GOVERNMENT MANAGEMENT

COMMITTEE ON GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

WASHINGTON, D. C.

23 JANUARY 1985

IMPROVEMENTS TO THE FEDERAL PROCUREMENT SYSTEM

Mr. Chairman and Members of the Subcommittee, I am pleased to have this opportunity to share my thoughts with you on the federal procurement system as it relates to the Department of Defense. Clearly, any system which dispenses on the order of a million dollars per working minute is both important and likely to be complex. Further, this system necessarily differs in fundamental aspects from everyday commercial practices to such a degree that simple attempts to transpose procedures from the former arena into the latter are almost assured of failure. The recommendations of the President's Private Sector Survey on cost control are by and large very sound -- however, in their particulars, they must be applied very selectively insofar as defense procurement is concerned.

Defense procurement differs in at least four important aspects from common commercial practice. First, unlike the normal commercial situation, the defense contracting arena represents a monopsony -- that is, there is but a single buyer. Second, after an initial and often intensely competed phase, the supplier may itself possess something approaching a monopoly. Third, the magnitude of the projects undertaken often represents several times the net worth of the contractor pursuing the effort and such projects frequently entail major technological risk. Fourth, the projects being pursued are of such importance that, in the aggregate, the nation's survival could depend on their outcome.

The Subcommittee has requested that I focus my remarks on seven particular factors addressed by the President's Private Sector Survey on Cost Control. These factors relate to the organization of the acquisition function; methods of improving cost estimates; scheduling and risk management; program stability; the role and responsibility of program managers; the use of competition; regulatory requirements; and the role of the Office of Federal Procurement Policy. These seven aspects can be conveniently discussed in terms of four groupings about which I happen to hold strong personal views: centralization, cost estimating, program turbulence and competition. With the Subcommittee's permission, I would therefore like to address the seven items in this latter framework.

CENTRALIZATION

The federal government has tended to become increasingly centralized in its defense procurement management in recent years. This has been driven in large part by the worthwhile objective of precluding errors at the operating levels of management; however, it has resulted in such a degree of overcontrol that it has as a by-product nearly precluded the possibility of successes from the lower levels of management. The basic tenant I would encourage would be to centralize policy and oversight and to decentralize the management of day-to-day operations.

Candidly, no private corporation competing in the open market could long survive with the degree of micromanagement which the Congress imposes on the Department of Defense and which the Office of the Secretary of Defense and Service Secretariats impose on the field commands responsible for executing programs. The model I would propose would be that, insofar as procurement is concerned, the Congress should play a role somewhat analogous to the Board of Directors of a large corporation. Secondly, the Office of Secretary of Defense should function in a manner somewhat similar to a corporate staff. Finally, the Services should function largely as would an operating division in industry.

It would be very helpful if the role of the Joint Chiefs of Staff could be strengthened in the military requirements area inasmuch as that organization alone possesses the military expertise and span of responsibility to deal with the burgeoning number of cross-service issues in the procurement arena. Technology, of course, embraces no particular respect for Service boundaries insofar as they affect roles and missions. However, if the Joint Chiefs of Staff is to be effective in dealing with multi-Service requirements, it would appear necessary that several changes in its fundamental operating structure be implemented. These changes would include placing the Chairman, as an individual, in the chain of command -- rather than relying on consensus of the four Service chiefs. The Chairman should also be provided with a staff directly responsible to his office, as well as a four-star military deputy to ease the workload of that enormously burdened position. With respect to the Office of Secretary of Defense and

the Service Secretariats, one way to assure that they focus on the issues which are likely to have the greatest consequence (as opposed to micro-managing) is perhaps to maintain them at a sufficiently small size that there is simply no alternative to the desired approach. The Office of Federal Procurement Policy in my opinion provides a useful, broad policy function. However, in my view, the specific procurement issues faced by the Department of Defense differ so substantially from issues faced by other departments -- and in fact, the issues faced by specific programs within the Department of Defense are themselves sufficiently unique -- that detailed controls imposed by the OFPP are likely to be counter-productive. In the end, the performing Service and its program managers must be given the resources and authority to make decisions and carry them out -- and then be held accountable for the outcome.

#### COST ESTIMATING

Cost estimating of research and development programs and initial production of the resulting end-items by definition entails considerable uncertainty. The current approach of applying fixed price contracts as a means of controlling the resulting risk would seem to me to be very inappropriate for most development programs (as opposed to follow-on production programs) and seems likely to lead to a repeat of the situation encountered as a result of the excessive use of Total Package Procurement during the 1960's.

With respect to cost estimating, it would appear that the most important steps which could be taken would be to: 1) establish independent, professional groups to do cost estimating and assign those groups the sole purpose of providing the cost estimates to be used in the budget process and, 2) include risk assessments (and therefore reserves) in all cost estimates. Cost estimating in the presence of uncertainty is inherently a probabilistic matter and to assume that cost can be treated as a discrete entity is altogether inappropriate. The same comments apply to the estimation of schedules. If such procedures were to be used for cost estimating the matter of risk management would then become quite straightforward -- inasmuch as the areas of risk would have largely been identified together with their potential magnitude. This permits appropriate management focus on the elimination or control of the risk producing tasks.

TURBULENCE

Although the apparently exorbitantly high costs of hammers, ladders, coffee pots, Allen wrenches, and plastic caps for stools seem to have mesmerized the attention of the media, the significance of these instances is diminutive in comparison with the inefficiencies caused by program turbulence. By program turbulence, I mean repeated change of schedules, funding, requirements, people and so forth. A major, and in fact possibly the major, consumer of senior management attention for those working on defense contracts, both in government and out, is the matter of keeping programs adequately funded -- and this effort is generally at the expense of what should be the principal management task, namely, focusing on properly executing those programs. Multi-year procurement is a useful mechanism for alleviating this problem. Multi-year budgeting would be an even more useful mechanism. Adopting a two-year federal budget would be one of the most important steps to improve the procurement process that I am able to contemplate.

From the contractor's standpoint, turbulence disincentivizes capital investments to improve productivity, diverts management attention from the important tasks at hand, demotivates employees and leads to schedule slips -- and therefore to cost increases. From the government's standpoint, turbulence all too often affords contractors an undeserved opportunity to escape contractual obligations by virtue of continual changes in the contracts which govern their work.

COMPETITION

Perhaps the government's most effective lever in managing its industrial procurement program is the use of competition. The approach for application of this powerful mechanism is straightforward -- the government need simply provide incentives which motivate the contractor to behave in the manner the government wishes. This necessarily includes the opportunity to make non-insignificant profits for good performance and to suffer penalties for bad performance.



It should be noted, however, that as with most other management tools, competition must be used carefully and with discretion. In some cases competition can be self-defeating -- an obvious instance being when a small quantity of items are to be bought of a type that require major initial investment to establish a production capacity.

#### ADDITIONAL OBSERVATIONS

Prior to concluding, I would like to offer brief comments in three additional areas which I believe to be particularly important. The first of these is the observation that one cannot manage complex development and production tasks merely by regulation or law. The blanket application of regulations can in fact all too often be counterproductive. The matters of implementation of the Prompt Payment Act and of acquiring data rights for the government are significant cases in point. With regard to the latter, by owning the data rights to the hardware which it pays to develop the government preserves at least a latent ability to compete the production of that hardware among a variety of sources. This is a very appropriate and desirable action. However, to indiscriminately demand data rights to all hardware which the government procures (as is often the case) simply befuddles the procurement process. Most commercial producers simply will not provide the government data rights to, for example, commercially developed automobiles, airplanes, computers, chemical processes, etc. -- and if they were to do so, the cost would be so enormous that the government clearly would be burdened beyond reason.

A second concluding observation which I feel, with regret, compelled to offer relates to the growing chasm which is building between government and industry at the policy level...as distinguished, importantly, from the working level. This is occurring precisely at the time that our competitors in the world marketplace, such as France and Japan, are drawing ever closer ties between their industry, government, universities and labor unions. This trend is, in my judgment, a consequence of U. S. Government frustration over what it perceives to be poor industry performance and industry frustration over what it perceives to be unreasoning government interference.

Finally, a comment is in order with respect to the quality of personnel involved in the government procurement system. Irrespective of the above recommended changes, it is of the utmost importance that the government have its share of the most talented and dedicated procurement specialists available to our nation. Today, the government is fortunate in having a cadre of such people. However, these people are continually being attracted away to other positions by the failure of the government to pay competitive salaries and by the frustration level these people suffer of operating in a burgeoning bureaucracy. But perhaps the most damaging circumstance of all is the current "non-surgical" attack on "fraud, waste and abuse." During the over a quarter of a century I have devoted to the defense industry, virtually at all levels in both government and industry, I have found the practitioners in that field to be almost uniformly of the highest dedication, competence and integrity. To lump fraud and waste together, for example, even when well intentioned, is to do a great disservice to those workers both in government and out. Fraud is treated by the legal system and those guilty of fraud should be prosecuted to the fullest extent of the law. In short, they deserve what punishment they get. Waste, on the other hand, is to one degree or another something of which we are all guilty -- in spite of our best efforts to avoid it. We must continue our maximum efforts to drive waste to an absolute minimum level. Yet, being humans, it is likely we will always suffer some degree of waste. The non-discriminating campaign being waged on "Fraud, Waste and Abuse" has had the unfortunate and I am sure unintentional result of branding an entire body of people in government and industry as scoundrels in the public eye. If we are to attract the type of young people we need to serve our government, and, for that matter, to enter our defense industry, we cannot afford to unjustifiably brand them with such aggregated and undeserved perjoratives.

Clearly, the procurement process as it exists today leaves a great deal to be desired, and in many instances American industry has fallen far short of what our government and our citizens have rightfully expected. These problems will not be solved by the addition of regulations, the imposition of more auditors or simplistic changes to the procurement system. Major revisions will be required ... with the items I have already suggested being perhaps a reasonable place to start.

Senator COHEN. The hearing is now recessed.  
[Whereupon, at 12:25 p.m., the hearing was recessed to reconvene at the call of the Chair.]

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

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EXCERPTS FROM THE

PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL

REPORT ON

PROCUREMENT/CONTRACTS/INVENTORY MANAGEMENT

APPROVED BY THE SUBCOMMITTEE FOR THE  
FULL EXECUTIVE COMMITTEE, SPRING-FALL 1983

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(157)



## THE PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL

August 31, 1983

The Honorable Ronald Reagan  
President of the United States  
The White House  
Washington, D.C.

Dear Mr. President:

The following Report represents the results of the Procurement/Contracts/Inventory Management Task Force of the President's Private Sector Survey on Cost Control in the Federal Government. The Task Force was chaired by Willard C. Butcher, Chairman, Chase Manhattan Corporation; Edward S. Finkelstein, Chairman, R. H. Macy and Company, Inc.; and C. C. Garvin, Jr., Chairman, Exxon Corporation, with Edgar A. Robinson serving as Project Manager. The Report culminates the combined efforts of over 40 members of the Task Force, who devoted about four person-months of pro bono work to the PPSSCC initiative. A list of all Task Force members is enclosed with this letter.

The Report on Procurement/Contracts/Inventory Management contains major recommendations which, when fully implemented, could result in three-year cost savings of \$20,271 million. It should be noted, however, that some of the recommendations may require several years for the savings to be realized. While all facets of Procurement/Contracts/Inventory Management could not be surveyed in the time allotted, areas selected for review were considered to offer significant potential for cost control and improved efficiency. The importance of the accompanying recommendations rests on the fact that they represent the potential for better utilizing finite resources available to the Federal Government.

Clearly, other opportunities for cost savings and revenue generation exist but, due to limited time and personnel resources, they could not be pursued. Several are suggested for further review because they offer future potential savings and revenue opportunities.

On behalf of the Co-chairs and the members of the Task Force, I would like to express our deep appreciation for the opportunity to have been of service to you and the members of your Administration.

Respectfully,

J. Peter Grace  
Chairman, Executive Committee

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## II. ISSUE AND RECOMMENDATION SUMMARIES

### A. PROCUREMENT

#### PROC 1: THE ROLE OF THE OFFICE OF FEDERAL PROCUREMENT POLICY AND THE TASK FORCE VIEW OF THE PROPOSAL FOR A UNIFORM FEDERAL PROCUREMENT SYSTEM

##### Issue and Savings

What should be the role of the Office of Federal Procurement Policy (OFPP)? What view does the Task Force have on the Uniform Federal Procurement System (UFPS) recommended by the OFPP?

The role of OFPP and how the Task Force views the UFPS is critical to the assessment of the individual procurement issues.

##### Background

Of the 149 specific procurement reform actions recommended by the 1972 Commission on Government Procurement, the centerpiece was the creation of OFPP. The office was to:

- o Be independent of any agency having procurement responsibilities.
- o Stand above the procurement agencies and have policymaking rather than advisory authority. The Commission recommended OFPP be placed in the Office of Management and Budget to avoid the conflict-of-roles problem experienced by the General Services Administration (GSA) with policy and service functions.
- o Be responsive to Congress and established by legislative rather than executive action.
- o Consist of a small, highly competent cadre of seasoned procurement experts.

In brief, the Commission's rationale for urging creation of a central policy office was based upon its findings that:

- o A void existed in procurement policy leadership. This void was compounded by a fragmented and outmoded statutory base.
- o Basic procurement policy could not be effectively managed without a centralized focal point within the Executive Branch. Prior to 1972, no Administration had established such a function. The Commission, however, did not favor centralized Federal buying for all agencies, control of agency business decisions, or another large bureaucracy.

From the agencies' viewpoint, the most important part of the recommendation was the Commission's belief that agencies should continue to be responsible for individual buying actions while OFPP exercised leadership to oversee development and application of effective procurement policies. The Task Force basically agrees with this important part of the Commission's findings.

On August 30, 1974, President Nixon signed Public Law 93-400 and OFPP became a part of the procurement process. This was one of several new agencies established under "sunset" legislation, and in 1979, via Public Law 96-83, OFPP was extended for four years.

In February 1982, OFPP submitted to Congress the Reagan Administration's proposal for procurement reform. This proposal and the accompanying legislative changes outlined a UFPS based on four major thrusts:

- o Streamlining and simplifying the procurement process. Such items as a single set of Federal Acquisition Regulations, increased use of simplified/functional specifications, and raising the threshold for small purchases and socio-economic programs from \$10,000 to \$25,000 were included.
- o Emphasizing new concepts of competition based on total cost, including life cycle and multiple factors cost competitions.
- o Establishing a new professionalism in the procurement workforce through such items as career management and development programs and qualifications standards.



- o Providing a new management structure with clear responsibility and accountability. Key to this reform is the creation of a procurement executive in each agency.

Not content to wait solely for Congressional action, the Administration promulgated an Executive Order (#12352 dated March 17, 1982) which began the work of improving the procurement process and implementing programs not requiring legislative action. The Administration, under the leadership of OFPP and OMB, has formed six interagency task groups to immediately begin designing the programs and standards to implement UFPS.

The task groups are individually addressing actions to put into place the initiatives of UFPS; these initiatives include establishing clear lines of procurement and contracting authority, establishing Government-wide systems and competition criteria, reducing administrative costs and burdens, simplifying small purchases, and developing procurement career management programs. Each task group has a charter and a timetable for action -- these are not study groups but catalysts for implementation.

After reviewing the procurement process during the Task Force's initial weeks in Washington, it was felt that these issues -- the role of OFPP and how the Task Force viewed UFPS -- were critical to our overall assessment of individual issues.

#### Methodology

The basic methodology was to interview various procurement officials in both civilian and defense agencies, outside the Government, and in OFPP. This provided a background on the scope of centralized procurement policy, procurement reform, and the effectiveness of the Office of Federal Procurement Policy.

#### Findings

Role of OFPP: after a period of 8 years, the assessment of how effective the OFPP has been leads to mixed reviews. To OFPP's credit, Government procurement has received more attention and coordination than in the past, and OFPP has succeeded in keeping many of the

1972 Commission's reform recommendations alive and progressing. To name a few:

- o Procedures for major acquisitions have been developed. The procedures apply to such acquisitions as buildings, transportation systems, defense, and space systems.
- o Programs for purchasing commercial products and contracting out certain services to the private sector have been developed and implemented; however, these programs are not progressing as fast as originally intended.
- o The Federal Acquisition Institute (FAI) was formed and has had an impact on establishing a more professional role for purchasing officials throughout the Government.
- o Substantial progress has been made on the development of a single set of Federal Acquisition Regulations.
- o Finally, a major step toward procurement reform has been taken through UFPS and the subsequent Executive Order and implementing interagency task groups.

While these successes have been notable given the state of the procurement process, it is also fair to state that the 1972 Commission's vision of a strong OFPP presiding over a smoothly functioning, uniform Government procurement system has not been fully realized.

The Task Force found that a central coordinating point is still required because of:

- o the size and importance of procurement spending as a portion of the Federal budget and projections of future procurement plans and the need for Government agencies to carry out more economical and cost-effective procurement activities; and
- o the desirable requirement for the Government to present singular rules, regulations, practices, and concepts to the private sector for contracting/procurement actions.

The second major concern after the issue of whether OFPP should exist at all is what the powers inherent in the Office and the Administrator should be. The original 1972 Commission and the 1974 enacting legislation established a regulatory role for the Office; however, in

the reenactment legislation in 1979, the regulatory role was downgraded. Currently in the OFPP proposal for the uniform system, the Office has responsibility to provide overall leadership and coordination in the development of Government-wide procurement policies. Further, the Administrator has the role of facilitating resolution of conflicting views when agencies cannot reach agreement on the content of Government-wide procurement regulations.

- o The Administration's current view is that OFPP does not necessarily require regulatory or directive authority to accomplish procurement reform.
- o At present, the three major procuring agencies, the Department of Defense (DOD), GSA, and the National Aeronautic and Space Administration (NASA) have individual regulatory authority and, in order for the proposal now before Congress to conform with the wishes of these agencies, OFPP regulatory authority envisioned in earlier versions was reduced to a leadership, policy guidance, and coordinating role.
- o The current Administration's impetus for procurement reform is to implement a new management structure for procurement, simplified procedures, consolidated regulations, career enhancement programs, etc.; and to have these basic and long overdue improvements diverted or diluted because of objections to the OFPP's regulatory role did not appear prudent.
- o In May 1982 after hearings were held by the Senate Subcommittee on Federal Expenditures, Research and Rules dealing with the role of OFPP, regulatory authority, and the new uniform procurement system, the following summary was developed by OFPP to compare various concepts:

The old procurement concept --

- Regulations drove the procurement process.
- Whoever had regulatory authority was crucial.

The new concept envisioned by the UFPS --

- The use of the heavy regulatory component as a way of managing procurement was to be downgraded over time.

- A management structure was to be established with clear lines of authority and accountability down through the contracting officer, a simplified procurement process, a professional workforce, operational performance standards, control and feedback mechanisms, and a means of fine-tuning the system to meet procurement demands.
- New OFPP legislative authority includes:
  - Responsibility to put the new procurement system into operation.
  - Agency-head appointed Procurement Executives with system-level responsibility working with OFPP; specific actions to upgrade the workforce; greater latitude for initiative and business judgement; and system certifications to agency heads to ensure proper implementation.
  - Procurement policies in legislation to bring Federal procurement into line with modern methods and requirements.
  - Responsibility to improve the system in the future through joint testing of innovative changes.
  - OFPP still retains policy authorization over all agency procurement, still retains authority to rescind agency regulations that do not conform to policy, and still has leadership responsibility to develop a simplified Government-wide regulation.

The Task Force found that the new role envisioned for the Office of Federal Procurement Policy is sufficient to accomplish procurement reform. The Task Force further found that examination of specific pieces of the proposal in isolation creates misconceptions and focuses attention on minute segments -- such as regulatory authority only. A system has been proposed, not individual procurement practice reforms -- the new role of OFPP should be viewed in the context of this system, not in isolation.

The role of OFPP and its authority is also inextricably linked to the organizational location within the Executive Branch. OFPP's current location in OMB provides a more logical place to operate than other agencies or separate locations because:

- o OMB's role places it in a strong oversight and coordination position relative to the procuring agencies.
- o The OMB Director has Cabinet rank and stature as part of the Office of the President. This provides needed access to Executive Branch authority and assists in implementing procurement reform. The March 1982 Executive Order is an example of this power base usage.

Although OFPP has been in OMB for eight years, further integration is necessary and desirable. In furthering procurement reform, additional efforts should be directed toward combining OMB's budget review and coordination role with reform implementation objectives and the annual budget review of major departments and agencies.

The Task Force has concluded that the Director of OMB should take management actions to incorporate OFPP and the procurement reform implementation objectives into the annual budget and program analysis processes. Further, this year, prior to the expiration of the law covering the establishment of OFPP, a review should be undertaken to decide whether OFPP should be continued as a separate office or its activities merged directly into OMB. The Task Force fully supports the continuation of a strong procurement policy-making coordinating role somewhere within OMB.

The Uniform Federal Procurement System -- The Task Force has reviewed the Administration's proposal for a Uniform Federal Procurement System and expresses the following views and findings.

UFPS is the most comprehensive procurement reform action to be recommended since the 1972 Commission on Government Procurement. UFPS addresses 85 problems and issues. These are either directly contained in the proposal or will be dealt with in the context of the new management structure and process envisioned within UFPS. Of the 85 items, 35 are left to be managed within the system and 50 are addressed in the proposal

There are two areas where the Task Force felt that the proposal could be made more effective and the procurement process enhanced:

- o First, in the current version of the proposal and the required statutory changes, no mention is made of giving multiyear contracting authority to agencies procuring under the Federal Property and Administrative Services Act (mainly civilian agencies) whereas the Armed Services Procurement Act provides multiyear authority. The rationale for multiyear contracting for major weapons systems is apparent, but the opportunity to save procurement funds through less expensive items based upon multiyear acquisition and the opportunity to match longer range planning (in excess of the current fiscal year) with actual contracts appears too desirable to ignore. The proposal is silent on the matter.
- o The second area of concern relates to the gradual approach to seeking enactment of a single Federal procurement statute. At the request of the major procuring agencies, OFPP adopted the concept of dual conforming statutes rather than a single law. This has the advantage of:
  - maintaining a link with the present process in order to provide continuity, avoid disruption, and maintain legal precedents established over more than 30 years.
  - not adversely affecting an agency's mission or ability to meet mission requirements.

A single procurement statute may still be desirable as a long-term goal, after the system is in place and operational experience has been gained and evaluated.

Notwithstanding these concerns, the Task Force has concluded that the Uniform Federal Procurement System proposal is a significant initiative that builds upon the existing procurement system with evolutionary steps. The system is evolutionary in that implementation would occur over a three to five year period and no significant changes are envisioned that would adversely affect existing agency roles, missions, or preparedness.



The Federal Acquisition Institute -- one other area within OFPP was included in the Task Force's appraisal.

- o The Federal Acquisition Institute was established in the original OFPP enabling legislation with the objective of promoting procurement research to encourage innovation and creativity. Initially, FAI was located in the Defense Department but was later moved to OMB to ensure it had Government-wide focus. During the Task Force's analysis we encountered several sources who indicated that FAI may be transferred from OFPP to another agency -- most often mentioned was GSA. While it is difficult to imagine this being done without legislative action, the consequences for implementation of UFPS could be significant. FAI is the only available in-house organization equipped to take a Government-wide view of the many parameters of UFPS that require research and educational assistance.
- o The Task Force has concluded that FAI should be retained in OFPP (and hence in OMB) in order that procurement research and education may be focused from a sufficiently high level to provide unbiased, policy-level results.

#### Conclusions

- o A central coordinating point is required because of the size and importance of procurement spending, and because uniform rules, regulations, practice and concept could then be applied to contracting/procurement actions.
- o A new role for OFPP is needed to accomplish procurement reform.
- o The OFPP needs to be part of OMB.

#### Recommendations

PROC 1-1: The Administration should continue its active programs for substantial reforms of the procurement process through the Uniform Federal Procurement System and a strong central leadership role for the Office of Federal Procurement Policy/OMB.

It should actively seek Congressional review and approval of the UFPS and the accompanying legislative changes in the Congress. Until it is given a priority by the Administration, action may not be taken.

PROC 1-2: The Administration should take direct action to fully integrate procurement reform and the role of OFPP into the existing budget/program review processes of OMB.

It should review this year, prior to the expiration of P.L. 96-83, whether OFPP should be merged directly into OMB to enable the Government-wide procurement policy and coordinating role to be carried out in the most effective manner.

PROC 1-3: The Administration should take direct action to retain the Federal Acquisition Institute in OFPP/OMB.

#### Savings and Impact Analysis

No quantification of cost savings is made for this issue.

#### Implementation

These recommendations require Presidential initiation to propose legislation and to issue directives to all agencies.

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### A. PROCUREMENT (CONT'D)

#### PROC 2: SOCIO-ECONOMIC PROGRAMS

##### Issue and Savings

What opportunities exist to reduce the burdens that various socio-economic programs place on the procurement process without impeding the objectives of such programs? Is the civilian agency \$10,000 limit for using simplified contracting procedures for small purchases too low?

Estimated savings in excess of \$847 million per year may be achieved by initiating a comprehensive reform of socio-economic programs implemented through the procurement process, tying the thresholds for socio-economic programs to the ceiling for simplified small purchase procedures, and raising the civilian agency ceiling for simplified small purchase procedures to \$25,000.

##### Background

There are currently some 80 programs that attempt to further socio-economic objectives by prescribing contract terms and/or sources utilized by Federal Government procurement officials. The major ones give preference to American labor and American-made goods; improve working conditions and wage rates for American workers; and assist small, disadvantaged, and minority-owned business firms. In recent years concern has grown regarding the cumulative effect of these programs on the procurement process in that they cause incremental administrative costs, increase delivery lead times, sometimes produce quality differentials in goods purchased, and give rise to inflationary impacts on the economy and a variety of other opportunity costs.

In addition, there is concern over the impact socio-economic programs have had on efforts to simplify procedures applicable to small purchases. Currently, any purchases by civilian agencies below \$10,000 and by the Department of Defense (DOD) below \$25,000 are subject to

simplified contracting and administrative procedures designed to reduce paperwork and speed the procurement process. However, many socio-economic programs apply to purchases of less than \$10,000 and require complex contract provisions which are in conflict with the intent of the small purchase procedures. Purchases by Government in amounts less than \$10,000 account for only about 8 percent of total procurement dollars spent but more than 97 percent of contracting actions.

#### Methodology

The Task Force reviewed numerous reports by prior study groups dealing with the overall impact of socio-economic programs on procurement as well as many analyses of individual programs conducted by Government agencies and private individuals. The Task Force also interviewed a number of Government officials involved in implementing the programs and several contractors who do business with the Government.

#### Findings

Based on the reviews of prior groups, the Task Force has established the following findings:

- o Some socio-economic programs being implemented via the procurement process may not be achieving their objectives either from a cost-benefit perspective or in an absolute sense.
  - Studies by several Government agencies have demonstrated that conditions have changed since some programs were initiated, making their continuation unnecessary and that, in at least one instance, the objectives of the program are not being met.
  - While the Task Force is not endorsing the conclusions of these specific studies, they do indicate the need to periodically review the effectiveness of programs vis-a-vis their original objectives.
- o There may be more cost-effective means to implement some socio-economic programs in lieu of use of the procurement process.

- In some cases the use of direct grants, tax incentives, and various licensing mechanisms may be more cost effective and less burdensome while producing the same results to the intended beneficiaries.
- o Some programs which are appropriately implemented via the procurement process may be incurring costs greater than necessary due to inefficiencies in the way they are administered.
  - Numerous suggestions have been made by both prior study groups and various Government agencies to lessen the administrative burdens of socio-economic programs without altering their fundamental objectives.
- o The difficulties in assessing the true costs of implementing socio-economic programs via the procurement process have discouraged previous attempts at comprehensive analyses and have served to foster the growth of new programs in recent decades.
- o The various thresholds and ceilings applicable to socio-economic programs inhibit the implementation of Government's simplified small purchase procedures.
  - The ceiling for simplified small purchase procedures has been set at \$10,000 for civilian agencies and \$25,000 for DOD.
  - The thresholds at which many socio-economic programs are applicable to procurements are lower than \$10,000.
  - The application of these programs at lower thresholds significantly negates the cost savings anticipated when the small purchase ceiling was raised by requiring the use of lengthy contract provisions in all but the smallest of Government procurement contracts. Inflation has rendered many of these socio-economic thresholds meaningless, especially those originally established during the Depression and World War II.
- o The ceiling for simplified small purchase procedures applicable to civilian agencies should be raised to the same level as that applicable to DOD.

- Such an increase from \$10,000 to \$25,000 would make an additional 78,000 contracting actions eligible for simplified procedures.

### Conclusions

To evaluate the effects of socio-economic programs on procurement costs, further analysis is needed to determine an appropriate, comprehensive plan of action. Procurement costs may be lowered while still meeting the goals of those programs.

### Recommendations

Based on the above, the Task Force recommends the following:

PROC 2-1: The President should propose a well defined joint project to be undertaken by the General Accounting Office (GAO) and the Office of Management and Budget (OMB), with assistance from major procuring agencies and departments, to analyze, by a certain date, the costs of major socio-economic programs which affect the procurement process. The study group should be charged with developing comprehensive proposals for changes in programs which fail to effectively meet their objectives, those which could be implemented through less costly means than the procurement process, and those which could be more efficiently administered.

PROC 2-2: The President should initiate by Executive Order a requirement that future socio-economic programs proposed to be implemented via the procurement process be subjected first to a cost/benefit analysis by OMB and, if appropriate, a DOD assessment of its impact on defense readiness.

PROC 2-3: The President should pursue legislation, either separately or as part of the proposed Uniform Federal Procurement System, to tie the thresholds and ceilings for major socio-economic programs to the ceiling for simplified small purchase procedures. A suggested list of such programs is contained in the Appendix to this report under separate cover.

PROC 2-4: The President should pursue legislation, either separately or as part of the proposed Uniform Federal Procurement System, to increase the ceiling for simplified small purchase procedures to \$25,000 Government-wide.



### Savings and Impact Analysis

Based upon analyses of individual programs conducted by various Government agencies and private study groups, the Task Force concludes that savings in excess of \$500 million per year can be achieved by developing a comprehensive package of reforms applicable to socio-economic programs which affect the procurement process. Savings in excess of \$200 million per year can be achieved by tying the thresholds and ceilings for major socio-economic programs to the ceiling for simplified small purchases and raising the latter to \$25,000 Government-wide.

We project savings starting in Year 3 of \$700 million (1983 dollars) or \$847 million with inflation or growth of procurement.

### Implementation

Recommendations PROC 2-1 and 2-2 both require Executive Orders. Legislative action is required for recommendations PROC 2-3 and 2-4.

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### B. WEAPONS ACQUISITION (CONT'D)

#### PROC 4: MULTI-YEAR CONTRACTING

##### Issue and Savings

What can be done to enhance the implementation of multi-year contracting in all Federal agencies?

Cost savings of over \$1.8 billion per year (\$1983) are possible through expanded use of multi-year contracting in all Federal agencies by the third year of implementation. Three-year cost savings could amount to \$3,415 million.

##### Background

Multi-year contracting (MYC) refers to any procurement contract used to purchase or obligate the Government for more than a single year's requirements of goods and/or services.

MYC is not a new concept. Several past studies have recommended MYC as a means for cost savings and there has been much Congressional testimony on the topic. The Department of Defense (DOD) adopted multi-year procurement as one of its major initiatives for improving the acquisition process, and the General Accounting Office (GAO) has recommended MYC authority for all Federal agencies.

Legislation governing MYC is not uniform across all Federal agencies. In the Defense Department, an MYC, by regulation, can extend from two to five years. Generally, civilian agencies cannot obligate the Government beyond the needs of the appropriation year. Therefore, unless specifically authorized by law, civilian agencies cannot enter into multi-year contracts.

In DOD, MYC authority has existed for years, but effective use has been restricted in the past due to a \$5 million statutory ceiling on reimbursement of contractor expenses in the event of contract cancellation. As a result, MYCs played only a very modest role in defense procurement in the 1970s. In 1982, the Department of

Defense Authorization Act was passed which largely relaxes or removes some of the restrictions placed on MYCs. The most significant change was raising the cancellation ceiling to \$100 million. However, Congress still requires review of all MYC candidates.

In some literature published by DOD, MYC has been called the single most important of the 32 initiatives in the Acquisition Improvement Program. Major potential benefits cited for MYC are:

- o It lowers procurement costs due to economies of scale in purchases of components or materials in lots of economic order quantity (EOQ) size.
- o It lowers leasing expenses and lowers the cost of service contracts in many Federal agencies.
- o It encourages contractors to make productivity enhancing investments.
- o It increases competition for the initial award.
- o It reduces administrative burden.

To qualify for MYC, a number of criteria have been adopted by DOD. GAO recommended using similar criteria for all Federal agencies. The criteria are:

- o MYC would yield substantial cost avoidance or other benefits.
- o The need for funding the item should be expected to be unchanged.
- o Relatively few changes in design anticipated, and there is reasonable assurance that cost estimates are realistic and that contractors can perform adequately.

Current use of MYC has been limited. Only a few major weapon systems have been approved for MYC by the Congress. In addition, the Defense Department is currently restricted from entering into MYCs for "commercial items." In the Defense Logistics Agency (DLA), only \$120 million of contracts are currently multi-year. On the civilian side, some agencies have only limited authority to enter into MYCs.

### Methodology

The Task Force interviewed senior acquisitions personnel in DOD and contractors in more than 15 civilian agencies and departments, and met with trade and industry organizations to discuss multi-year contracting. The Task Force also conducted an extensive literature search.

### Findings

In procurement of weapon systems there are a number of inhibitions to accelerating implementation of the multi-year initiative which surfaced during our interviews.

There is a requirement of up-front funding for purchases of EOQ components and materials. Procurement of more than one year's needs of components to take advantage of quantity discounts must be budgeted in the current year. There is a sense that EOQ funds used in the current year are removing funds from other legitimate requirements. (The specific budgeting procedure is discussed later in this section.)

When selecting candidates for MYC, programs with a small likelihood of cancellation should be chosen to maximize the benefits of MYC. Using the criteria described earlier, in effect, the MYC candidate list would resemble a "stable programs list," the development of which has been an Office of the Secretary of Defense (OSD) objective for some time. The Services are reluctant to identify stable programs because of the dynamic nature of technology and perceived threats to the nation's security. MYC, therefore, may restrict future DOD and Congressional flexibility if priorities change.

Although one of the benefits cited for MYC is increased competition at the time of initial award, after initial award there would be less opportunity for competition since prime and subcontractors have a multi-year commitment from the Government.

There appears to be some confusion regarding the relatively complex budgeting procedures used for MYCs in DOD. For example, a multi-year buy of a finished item can require several budgeting procedures depending on the time frame and quantity of the finished item. Also, differing

budget procedures for parts to be assembled into the finished item may apply. This myriad of procedures is not well understood and is often counterproductive in the efficient use of MYC.

For non-recurring costs (e.g., any one-time investments made by the contractor), upon cancellation the maximum amount that the Government would pay the contractor is referred to as the cancellation ceiling. This amount is not budgeted.

While current budgeting procedures may be a reasonable compromise which has evolved over time, there appears to be a level of complexity unnecessary to accomplish the primary objective.

In addition to weapon systems procurement, there are other MYC opportunities that exist in the Defense Department. In DLA and in the Services, purchases of war reserve items, equipment, and services are being studied for MYC possibilities.

A summary of 12 multi-year candidates presented by OSD to the House Appropriations Defense Subcommittee in August 1982 showed significant savings but did not indicate the discounted cash flow return. Our computations showed that the returns ranged from 20 percent to 56 percent and averaged 28 percent. Discounted cash flow returns should be used in determining which candidates for MYC are to be recommended. (See the Appendix.)

### Conclusions

Multi-year contracting could be beneficial to Government procurement if procedural inhibitions were eliminated. Budgeting processes are relatively complex for multi-year contracting as opposed to current year contracting. For procurement of weapons systems, MYC may be necessary to obtain EOQ. In other areas of both civilian agencies and DOD, MYC offers significant savings potential in the areas of photocopying, building services, equipment acquisition including computers, and maintenance.

### Recommendations

PROC 4-1: The use of multi-year contracting should be expanded in all agencies, consistent with established criteria. Although MYC is by no means a panacea, we believe that when applied appropriately, MYC offers substantial cost savings opportunity. Emphasis should be on

establishing a successful track record, and initially focusing on programs with low risk, i.e., a low likelihood of cancellation and high probability of achieving projected cost savings.

PROC 4-2: The use of a Discounted Cash Flow (DCF) methodology in all agencies to evaluate the relative attractiveness of various multi-year candidates is an important step. Opportunities for even higher returns should be exposed even if they entail higher risks so that those considering decisions have this additional input.

PROC 4-3: In weapon systems acquisition, a position should be established in OSD, and a similar position in each of the Services, to be focal points for data collection, review, advocacy, and monitoring of the MYC initiative. In OSD, this position could report directly to the Deputy Secretary of Defense to emphasize the importance of this initiative. Also, OSD Planning Analysis and Evaluation (PAE) should establish annual targets (e.g., specific percentages of the annual budget) for each Service to bring forward multi-year candidates.

PROC 4-4: We recommend that comptrollers review the current procedures with an eye toward simplification, e.g., all termination and cancellation related costs could be unfunded. Specifically, the budgeting system seems overly complex, particularly in funding various types of termination and cancellation related costs.

In regard to additional Total Obligational Authority (TOA) needed for funding EOQ buys, we believe that the Services should not be penalized for proposing MYC candidates. Whatever funding deemed necessary should continue to be separately handled at the OSD level and monitored by comptrollers and the Defense Resources Board (DRB). The amount reserved for additional TOA should be developed by OSD-PAE.

In acquisition of items other than weapons in the Defense Department, we believe that targets should be identified.

Specific goals should be endorsed by OSD Acquisition Management. DLA and the Services should work with OSD Acquisition Management to change the restrictive wording in the Defense Acquisition Regulation (DAR) which currently limits DOD from using MYC in acquiring "commercial items."



PROC 4-5: In the civilian sector, the Uniform Federal Procurement System (UFPS) proposal should be modified to embrace MYC. Confusion that exists regarding authority to enter multi-year contracts in civilian agencies should be clarified in UFPS.

OFPP should also be the focal point for data collection, review, advocacy, and monitoring for MYC in the civilian agencies. In coordination with the agencies, OFPP should develop a comprehensive list of potential MYC candidates; with this data base, annual targets for each agency should be developed. Further, based on a comprehensive list of candidates, OFPP should structure a pilot program of MYCs to demonstrate savings potential to Congress.

#### Savings and Impact Analysis

Potential savings for MYC in procuring major weapon systems was estimated by OSD. It identified some 31 programs for the period FY 1984 through FY 1988 which, in its opinion, met the criteria for MYC. Its estimate on these programs was an average annual savings of \$1.573 billion in "then year" dollars. It appeared that additional total obligations authorities of only \$2 billion were needed to achieve this cost savings.

Excluding weapons systems, there is additional opportunity for MYC in DOD and on the civilian side. For example, extending ADP equipment and photocopying leases as well as multi-year contracting for building services also have significant savings potential. Use of MYC in these areas could reduce costs by \$242 million per year.

To summarize the potential cost savings that could amount to \$1.8 billion annually by the third year:

|                 | (\$ millions) |                |                |                |
|-----------------|---------------|----------------|----------------|----------------|
|                 | <u>Year 1</u> | <u>Year 2</u>  | <u>Year 3</u>  | <u>Total</u>   |
| Weapons systems | \$450         | \$ 935         | \$1,573        | \$2,958        |
| Other systems   | 50            | 165            | 242            | 457            |
| Totals          | <u>\$500</u>  | <u>\$1,100</u> | <u>\$1,815</u> | <u>\$3,415</u> |

Implementation

The Administration should propose new legislation to use multi-year contracting where existing law prevents economic procurement:

- o increase the role of OFPP to advocate and monitor multi-year contracting;
- o simplify the budget process to facilitate multi-year contracting;
- o use discounted cash flow methodology to better identify and select candidates for multi-year contracting;
- o establish a focal point within OSD and each of the Services to advocate and monitor MYC. Similarly, the OFPP role of advocating MYC should be enhanced with respect to Government-wide procurement.

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### B. WEAPONS ACQUISITION (CONT'D)

#### PROC 8: COST ESTIMATING AND SCHEDULING

##### Issue

How can current estimating, scheduling, and risk management techniques be improved and incentives put into the system to improve cost/schedule estimates and produce the "most likely" results?

Improved systems can result in three-year cost savings of \$2,940 million.

##### Background

Cost estimates and schedules for major weapons systems are areas of considerable ongoing attention and Congressional, media, and public focus. The March 1982 Department of Defense (DOD) Selected Acquisition Report (SAR) cost summary on 42 major weapons acquisition programs showed an average cost overrun of about 15 percent (including escalation and quantity changes) from the Milestone II (Program Go-Ahead) estimates for the programs. The variability on individual programs ranged from a growth of 1,800 percent to a decrease of 30 percent. (Table I of issue II D 3 in the Appendix provides additional details regarding this growth.)

Excluding escalation and quantity changes, the average growth in the SAR was about 25 percent, and this was attributable largely to technical changes and estimating deficiencies. The consequences of inaccurate estimates are program instability and reprogramming, as well as loss of credibility with the Congress, media, and public.

As the budgetary process is structured, there are pressures or incentives for producing low estimates. For example:

- o Early estimates are based largely on input from technologists who will not have a role in program implementation, so there is a tendency to see only the merits of new technology and overlook

the risks and implementation difficulties they introduce.

- o Program Managers are judged in part by how well they convince their superiors that funding should be provided for their programs. Low estimates and short schedules aid this objective.
- o The Services can get more programs started for a given funding level if estimates are on the optimistic side.
- o Program Managers feel that since program estimates are in the public domain, realistic estimates would be self-fulfilling, i.e., put them at a disadvantage in getting competitive bids from contractors.

In an attempt to improve estimate accuracy, several independent groups have been established within each Service and DOD to review program estimates/schedules or prepare independent check estimates of program costs and schedule. The number of independent reviews conducted for major programs varies from Service to Service; generally there are two, one at the Service level and the other at the DOD level. In practice, this has resulted in several versions of program cost/schedule estimates at any given time. Generally, the highest estimate is selected or portions of individual estimates are combined into the resultant estimate which then serves as the program budget.

The Weapons Team was unable to judge the effectiveness of these reviews in improving estimate accuracy. A recent article in Concepts entitled: "Improving Cost Estimating in the Department of Defense" attributed increased accuracy to program estimates for which an independent review was conducted by the Office of the Secretary of Defense (OSD) Cost Analysis Improvement Group (CAIG). In the private sector, it is generally felt that the benefits of multiple reviews are not commensurate with the additional effort required.

Quantity changes and escalation are a major component of program cost growth, accounting for 125 percent of the 150 percent noted earlier. These factors are generally outside the control of the Services. However, other factors such as engineering changes and estimating methodology, which account for the remaining 25 percent of the growth, also contribute to program cost growth, and those

are properly considered to be within the ability of the Services to control.

There is a consensus that the existing methodology for cost control during the engineering and reproduction phases of a program is not sufficiently timely to permit management to anticipate problems and take corrective action.

The fiscal 1983 budget for the Department of Defense (excluding Personnel, Construction, Housing and Revolving Fund) is \$184 billion. Of this amount, approximately \$60 billion will be spent for major weapons systems acquisition.

### Methodology

To review the program management planning, cost/schedule estimating and contracting issues, Team members with extensive industry experience in these disciplines were utilized. Interviews were conducted with personnel involved at various levels in the acquisition process including OSD, the Services, and industry. In addition, four ongoing major weapons programs (Air Force, Army, NAVAIR, and NAVSEA) were visited and representative key Service and prime contractor personnel were interviewed.

In all of the above activities, over 150 interviews were conducted with people in OSD, the Services, and in contractor organizations. In addition to interviews, extensive use was made of the previous major studies of the acquisition process, course material from the Defense System Management College (DSMC), published DOD and Service regulations governing acquisition procedures, and various published articles on the acquisition process which had been suggested by individual interviewees.

Findings and conclusions were based on all of the above activities, including observed strengths as well as opportunities for improvement. Recommendations and proposed implementation steps which are intended to respond to the opportunities for improvements were developed. Recommendations are viewed as reinforcing and complementing a number of actions, including the Acquisition Improvement Program (Carlucci Initiatives), which OSD and the Services have underway as part of their ongoing efforts to improve the weapons acquisition process.

### Findings

To give deserved balance to the report of the Weapons Team, it should be recorded that a number of significant strengths were observed in the acquisition process. The Team's overall assessment of the performance of DOD and the Services in the acquisition process is that it is reasonably effective considering the complex environment in which it operates. Nevertheless, opportunities exist for improvement.

Significant findings and conclusions drawn from the data gathered by the Weapons Team in the areas of opportunities for improvements in cost estimating and scheduling are:

- o Estimates and schedules tend to be optimistic and based low, leading to what is referred to as a "buy-in" phenomenon.
- o The existence of independent groups at several levels in the Services and DOD which either check program estimates or produce independent estimates of program cost diffuse the estimating effort and contribute to a lack of "ownership" or organizational identity with, and accountability for, the program estimates, thereby stretching resources which are in short supply.
- o The estimating function is generally part of the Comptroller's function and not an independent group. It is "buried" in the organization and has no strong identity. Based on the population interviewed, the Task Force observed that the qualifications/background of personnel assigned to estimating is too heavily weighted toward business/accounting skills; not enough emphasis is placed on technical qualifications.
- o There are no scheduling functions, as such, in the Services. Scheduling is generally reactive, and emphasis is placed on meeting required production rates rather than identifying cost-effective optimizations. Not enough emphasis is placed on identifying resource restraints that might affect the program schedule.

Scheduling analysis can be thought of as conducted on two levels, "tactical" and "strategic." "Tactical" is the term used to describe the day-to-day scheduling of material and labor



which takes place during the production phase of the program. This type, which is generally the contractor's responsibility, appears to be accomplished adequately. "Strategic" is the term used to describe the long-range, conceptual planning which should take place during the early stage of program development. This type of scheduling, which is the more difficult of the two, is generally the responsibility of the Services but is usually not done and is not usually used as input to the cost estimate.

- o There is no effective estimate/schedule classification system which relates the quality and accuracy of the estimate/schedule to the degree of definition of technology/hardware, the program execution information available, and the estimating/scheduling methodology used. Such systems are in place in the private sector and serve as an excellent means for communicating with management on the quality and accuracy of estimates/schedules. Based on statistical analyses, the amount of estimate contingency and schedule reserve required to remove bias is developed for each class of estimate/schedule and the statistical accuracy of each class is defined and known by management. At least one of the Services has recognized the need for an estimate classification system and has developed what the Weapons Team considers to be a rather rudimentary system which does not possess the desired characteristics. Nonetheless, it is a step in the right direction.
- o Risk analysis methodology is not in general use and when used, has a narrow focus. Recent applications have largely been limited to assessing hardware variability during the research and development (R&D) phase and do not address overall program risk (e.g., scope changes, escalation changes, production factors). Risk analysis is viewed as a vehicle to increase the level of the program estimate, but is not used in a risk management sense, i.e., to initiate actions which could eliminate or mitigate the identified risks.

The Army has developed a system called "Total Risk Assessing Cost Estimate" (TRACE) which addresses unanticipated difficulties, or risks, which effect the R&D phase of weapons development. The Weapons Team understands that, in some

cases, the system is being extended to include later phases of the program, e.g., full scale development and production. The Weapons Team supports these efforts and encourages their continued development and expansion to include risk management and general use.

- o Program budgets/schedules are rebaselined within the Services to varying degrees after a major change has been made or a major milestone has been achieved. However, Selected Acquisition Reports reconcile program costs to Milestone II estimates which might be many years old. As a result, current trends and developments which could be controlled are often masked by historical development which can no longer be changed.
- o Contingency, or management reserve, is not shown as a line item in estimates. This, together with the lack of rebaselining of estimates, leads to reconciliations which are of limited value and can be misleading. It also hampers effective management of the contingency account and cost control.

Program estimates typically contain management reserve which the Services feel is necessary to allow for estimating error and for risks to the program and technical changes which are undefined but experience has shown will take place. This management reserve is buried in various parts of the estimate and not identified as a line item for fear that it will be considered to be "fat" and eliminated during the budgeting process. The Program Manager may or may not know how much management reserve is in the estimate and where it is buried. Since it cannot be identified, management of the reserve account is not effective. Also, SAR reconciliations do not explain where the management reserve was used.

- o Emphasis in the cost area is heavily focused on cost reporting as opposed to cost forecasting and control, leading to "surprises" when cost overruns occur and insufficient opportunities for management to take corrective actions.

Government regulations focus on cost reporting and the Weapons Team viewed as a strength the well-defined cost reporting systems which are required by regulations (albeit the systems

appear to be overly cumbersome and consume contractor resources). But there appears to be insufficient emphasis on cost trending and forecasts. As a result, when overruns are identified it is often too late to take corrective measures. Finally, there appears to be a reluctance to report "bad news" in the cost area to management.

- o Program changes are a major source of disruption. The change procedure for engineering changes which are developed within the program is too lengthy, often taking a year from the time of submission of the change to its approval. External changes, e.g., configuration changes which come from outside the program, are sometimes imposed without giving the program team sufficient time to properly evaluate the cost/schedule impact. Justification for changes and identification of the originator of the change are not always recorded.

#### Conclusions

- o Program estimates and schedules are optimistic and overly reviewed and need organizational change.
- o An effective estimate classification system and risk analysis methodology need to be developed for broad application within the Services.
- o Government regulations stress cost reporting rather than cost forecasting, resulting in inappropriate focus to take corrective action.

#### Recommendations

PROC 8-1: The OSD and the Services should strengthen the cost and schedule functions of each Service, institute greater discipline over cost estimates and schedule development to produce "most likely" results, and improve "early warning" indicators to enhance management prerogatives and to exercise cost control.

PROC 8-2: The OSD and the Services should establish an SAR reporting format that presents cost figures adjusted for the effects of inflation and quantity change. Such information would provide more insight into real program developments than the current format does. By mutual consent of the DOD and the Congress, rebaseline major weapon system programs that undergo significant configuration change (e.g., aircraft model changes).

### Savings and Impact Analysis

After developing recommendations and proposed implementation steps for each issue area, the Weapons Team estimated cost savings which might be achieved and identified other positive impacts, if the Team's recommendations/implementation steps were adopted by DOD and the Services. The purpose of this effort was to define the incentives for DOD and the Services to give serious consideration to, and implement, the results of the Team's study.

The approach used by the Team to estimate potential cost savings was to evaluate the observed performance of DOD and the Services in the acquisition process compared with the performance of the private sector in the implementation of major capital investments for new facilities. Although the approach is largely judgmental, it has proved to be an effective tool and is used in the private sector for comparing/evaluating available alternatives. In making this comparison, the differences in environment were recognized, and the estimated potential savings are those which the Team believes are achievable within the existing Government environment.

Based on this approach, the Weapons Team estimated the implementation of the recommendations set forth in PROC 8 could result in savings, by the third year, of about \$1.5 billion on a base of \$60 billion/year, or about 2-3 percent of annual spending for weapon systems. As mentioned earlier, the four areas studied by the Weapons Team collectively deal with the fabric of the acquisition process. As such, they are not totally independent and have a synergistic effect on the overall acquisition process.

The cost savings, with 10 percent inflation, are projected to be:

| (\$ millions) |               |               |              |
|---------------|---------------|---------------|--------------|
| <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> | <u>Total</u> |
| \$300         | \$825         | \$1,815       | \$2,940      |

### Implementation

The steps outlined below are proposed to implement these recommendations. It is judged that most of these implementation steps can be accomplished by DOD and the Services within their current authorities. Exceptions are the use of program-specific escalation rates which could

require Presidential staff agreement, and, while rebaselining can be done by DOD for its own internal use, it would require Congressional approval to rebaseline estimates used in SAR reconciliations.

- o Integrate all resources within each of the Services which are devoted to reviewing/checking program estimates into the organizational unit within the "Systems" Command which is charged with initially preparing the estimates. This will ensure that the resources of the Services are concentrated on preparing estimates and will define a single point of responsibility for the quality of estimates.
- o Integrate the scheduling functions into the estimating functions in recognition of the strong linkage between cost and schedule. Increase the emphasis on technical skills as opposed to business/accounting skills within the combined functions.
- o Strengthen the stature of the cost/schedule function within each "Systems" Command. This can be achieved by establishing it as a separate and distinct function rather than being submerged within the comptroller's organization.
- o Make the integrated estimating/scheduling function responsible for preparing cost and schedule. Increase the emphasis on technical skills as opposed to business/accounting skills within the combined functions.
- o Make the integrated estimating/scheduling function responsible for preparing cost and schedule estimates for all programs. The "Systems" Command should produce a single, best estimate and schedule and assume "ownership" of them. Program Managers should be responsible for reviewing/approving estimates/schedules for their program prior to their acceptance by the "Systems" Command. (Attachment B-1 to Issue PROC II D 3 in the Appendix illustrates the relationships that would exist between the various functional groups.)
- o Develop an estimate/schedule classification system which relates the quality and accuracy of the estimate/schedule to the degree of definition

of the hardware/technology, the program execution information available, and the estimating/ scheduling methodology used. The system should also define the statistical accuracy of each class of estimate/schedule as well as the estimate contingency and schedule reserve which are required to eliminate any bias that may be present.

- o Enhance risk analysis methodology to cover potential risks during all phases of the program from R&D through production and deployment. Use this approach to produce "most likely" estimates/schedules. Also, input these identified risks into the Program Management Plan (PMP) where actions should be developed to mitigate or eliminate the adverse effects of the risks.
- o Assign responsibility for designing, developing, and maintaining the technology required to produce sound budgets and schedules to a single entity within the "Systems" Command's integrated estimating/scheduling function. The major components of this technology should be:
  - cost estimating and scheduling methods;
  - cost/schedule data collection and analysis procedures that draw on external as well as internal sources of data;
  - escalation forecasts that reflect the particular weapons systems industry; and
  - estimate/schedule accuracy analysis procedures to improve future accuracy.
- o Use escalation forecasts which reflect a program-specific "market basket" rather than the overall industry average.
- o Identify contingencies in estimates and reserves in schedules and make the Program Manager for managing the estimate contingency and schedule reserve accounts on his or her program.
- o Evaluate/upgrade contractor's cost/schedule forecasting and control system and key personnel during the bid review stage. Emphasize control after award by assigning a dedicated program management staff cost/schedule specialist to monitor



and appraise the contractor's performance. Reinforce this effort with periodic followup visits by senior control systems experts.

- o Reduce excessive cost reporting requirements imposed on the contractor. Place more emphasis on providing timely trend analysis information to management.
- o Streamline change procedures, e.g., consider parallel review activities and higher approval authority for Program Managers. Appropriately identify the justification for and the originator of the change.

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### B. WEAPONS ACQUISITION (CONT'D)

#### PROC 9: PROGRAM MANAGEMENT

##### Issue and Savings

What can be done to enhance the role, responsibility, authority, and accountability of the Program Manager (PM) and improve the efficiency/effectiveness of program management?

Improvement of the PM role could result in three-year cost savings of \$980 million.

##### Background

Department of Defense (DOD) Directive 5000.1, covering Major System Acquisitions, establishes the basis for weapons systems acquisition programs, including management principles/objectives and fundamental responsibilities of line authority from the level of the Office of the Secretary of Defense (OSD) through the assigned PM. Within DOD, the three Services (Air Force, Army, and Navy) are responsible for administering the acquisition programs. Further, within the Services, the organizations most directly involved are the various "Systems" Commands and "Commodity" Commands.

The Services and their responsible subordinate Commands augment DOD 5000.1 by publishing acquisition regulations and guidelines covering program management and the role of the PM. These publications generally establish the Services' program management concepts, responsibilities, policies, and procedures to be implemented by the assigned PM. Typically, subjects such as the PM's "charter," establishment of his or her staff and office, communications/reporting channels, interface relationships, functional support organizations and activities, and other salient aspects of program management are addressed. The content of these publications and the depth of coverage varies depending upon the Service.

In general, the PM has overall responsibility for, and is the advocate of, the acquisition program to which

assigned. In the case of a major weapons system, the PM has a great deal of responsibility for a wide range of political, technical, business, administrative, and management matters. The success of the program depends, in large part, on the PM's authority matching responsibility, adequate resources being made available for the team, strong functional unit support, and the ability to lead and orchestrate the total effort.

In recent years, there have been at least ten major studies undertaken to evaluate the acquisition process. Some have been specific to one Service while others have evaluated the entire process across DOD. Most of these studies have identified several areas in which recommended changes could produce improvements to the acquisition process. The Weapons Team has reviewed many of these reports and has identified seven which recommend that the overall process be improved through changes in the current program management structure and techniques. Principal recommendations have addressed the need to enhance the responsibility/authority of the PM and strengthen program management staffing through improved personnel policies.

The Weapons Team notes that the management of major weapons systems programs has long been identified as a problem. The recommendations in the aforementioned studies have been reasonably consistent with each other, and implementation appears to be within the capability and authority of the Services. In spite of this, each subsequent study "discovers" similar issues and makes similar recommendations; thus, the underlying root problems must be continuing in nature. These studies aided in focusing the Team's investigations and formulating the Team's findings and conclusions.

The fiscal 1983 budget for the Department of Defense (excluding Personnel, Construction, Housing and Revolving Fund) is \$184 billion. Of this amount, approximately \$60 billion will be spent for major weapons systems acquisition.

#### Methodology

To review the program management planning, cost/ schedule estimating, and contracting issues, Team members with extensive industry experience in these disciplines were utilized. Interviews were conducted with personnel involved at various levels in the acquisition process including OSD, the Services, and industry. In addition, four ongoing major weapons programs (Air Force, Army, NAVAIR, and NAVSEA) were visited and representative key Service and prime contractor personnel were interviewed.

In all of the above activities, over 150 interviews were conducted with people in OSD, the Services, and in contractor organizations. In addition to interviews, extensive use was made of ten previous major studies of the acquisition process, course material from the Defense Systems Management College (DSMC), published DOD and Service regulations governing acquisition procedures, and various published articles on the acquisition process which had been suggested by individual interviewees.

Findings and conclusions were based on all of the above activities, including observed strengths as well as opportunities for improvement. Recommendations and proposed implementation steps which are intended to respond to the opportunities for improvements were developed. Recommendations are viewed as reinforcing and complementing a number of actions, including the Acquisition Improvement Program (Carlucci Initiatives), which OSD and the Services have underway as part of their ongoing effort to improve the weapons acquisition process.

#### Findings

To give deserved balance to the report of the Weapons Team, it should be recorded that a number of significant strengths were observed in the acquisition process. The Team's overall assessment of the performance of DOD and the Services in the acquisition process is that it is reasonably effective considering the complex environment in which it operates. Nevertheless, opportunities exist for improvement.

Significant findings and conclusions drawn from the data gathered by the Weapons Team in the areas of opportunities for improvement in program management are:

- o The responsibility of the "Systems" Commands or the "Commodity" Commands for program results and the PM's activities is not always apparent, and the Commands do not appear to fully underwrite PM and program performance. A representative commentary on the process was "the PM stands alone in a high-risk job." Support from the Commands to the PM tends to be reactive, not proactive.
- o The responsibility, authority, and accountability of the PM are often a mismatch, given the way the system actually works. There is some evidence of erosion of the PM's authority relative to his "charter."

- o The scope of the PM's responsibility often does not include all aspects of the program, e.g., through deployment and logistics; consequently, the overall program tends toward less than full optimization.
- o Multi-layered staff and management briefings, special reports, down-flow questions from staffs, investigations/studies divert the attention of the PM and his team from managing the program. The "Systems" and "Commodity" Commands do not effectively shield the PM from these nonproductive activities, and in fact, the various Service staffs contribute significantly to the down-flow questions. Moreover, staff groups at all levels can restrain programs, but are not responsible for the adverse results of their input (e.g., "many people can say 'no', few people can say 'yes'"). As a result, PMs say they spend as much as 50-80 percent of their time in staff briefings of which only a small part is considered to represent productive activities.
- o Military and civilian personnel programs do not generate enough experienced people and there is high personnel turnover, both of which are detrimental to successful implementation of acquisition programs. Career paths in program management are limited for both military and civilian personnel.
- o There is a perceived difficulty in using outside resources to provide management support services even when suitable skills within the Services are unavailable.
- o The overall system/organization does not facilitate program success to the extent it should and depends upon strong, aggressive, and innovative individuals in the PM role to move programs ahead.
- o Concern with future audits/investigations leads to defensive management, e.g., conservative or "regulation" approach, use of "defensive" files, reluctance to delegate, and restraints on initiative.

### Conclusions

- o The PM could be better supported by the Systems and Commodity Commands.
- o The scope of the PM could follow the program through deployment and logistics to good advantage.
- o The overall system of PM could better facilitate program success.

### Recommendations

PROC 9-1: The OSD and the Services should fully integrate the program management organization/system in each Service to actively support and underwrite the effectiveness of PMs and strengthen discipline and delegation of authority in the acquisition process.

PROC 9-2: The OSD and the Services should establish positive career paths leading to flag rank in each program management skill area for personnel in the Services and the Civil Service; increase the use of technically trained people in all program management skill areas; and consider greater use of outside resources, when needed, to complement resources and skills available in the Services in program management skill areas.

### Savings and Impact Analysis

After developing recommendations and proposed implementation steps for each issue area, the Weapons Teams estimated cost savings which might be achieved, and identified other positive impacts, if the Team's recommendations/implementation steps were adopted by DOD and the Services. The purpose of this effort was to define the incentives for DOD and the Services to give serious consideration to, and implement, the results of the Team's study.

The approach used by the Team to estimate potential cost savings was to evaluate the observed performance of DOD and the Services in the acquisition process compared with the performance of the private sector in the implementation of major capital investments for new facilities. Although the approach is largely judgmental, it has proved to be an effective tool and is used in the private sector for comparing/evaluating available alternatives. In making



this comparison, the differences in environment were recognized, and the estimated potential savings are those which the Team believes are achievable within the existing Government environment.

Based on this approach, the Weapons Team estimated that implementation of the recommendations set forth above could result in savings, by the third year, of about \$500 million (1983 dollars) on a base of \$60 billion/year, or about 1 percent of annual spending for weapons systems. As mentioned earlier, the four areas/issues studied by the Weapons Team collectively deal with the fabric of the acquisition process. As such, they are not totally independent and can have a synergistic effect on the overall acquisition process.

Three-year cost savings are projected to be:

(\$ millions)

| <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> | <u>Total</u> |
|---------------|---------------|---------------|--------------|
| \$100         | \$275         | \$605         | \$980        |

#### Implementation

The steps outlined below are to implement this recommendation. It is judged that these implementation steps can be accomplished by DOD and the Services within their current authorities.

- o Within each Service, assign the "Systems"/"Commodity" Command clear responsibility for program performance. Fully integrate all program management functions (e.g., planning, estimating, scheduling) within each Service at the "Systems"/"Commodity" Command level. The "Systems"/"Commodity" Command should actively support and underwrite the performance of the PM and his or her team.
- o Limit other Command/Service-level program management functions to policy and coordinating activities which clearly transcend the integrated PM support activities and individual programs. Ensure that program management functional staffs at the "Systems"/"Commodity" Commands provide active support to the PM and do not act merely as a reviewing/critiquing activity.
- o Ensure that the PM's authority is consistent with his or her accountability and responsibility. The PM should have authority to advance the

program within the approved Program Management Plan (PMP), provided that all budgets, schedules, and planned steps are not contravened.

- o Broaden the scope of the PM's responsibility to encompass all phases of the program from research and development (R&D) through deployment and logistics.
- o Have the PM provide brief progress reports to "Systems"/"Commodity" Command principals with preagreed content and timing. Insofar as possible, "Systems"/"Commodity" Command staff briefings should be replaced by these progress reports.
- o Set pre-established milestones for briefings required outside the "Systems"/"Commodity" Command. These should be collective briefings with line principals and their supporting staffs.
- o Require the "Systems"/"Commodity" Commands to reduce down-flow questions, special reports, investigations/studies, and other non-productive activities imposed on the PM from all levels.
- o Conduct periodic technical reviews of programs by other experienced program management personnel within the Commands to provide an independent assessment of potential problems.

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### D. CIVILIAN AGENCY ORGANIZATION

#### PROC 14: GENERAL SERVICES ADMINISTRATION

##### Issue and Savings

Are there opportunities for Government procurement, contracting and inventory management for the civilian agencies?

Certain management improvements and changes instituted in the General Service Administration (GSA) would result in substantial cost savings, but these have not been quantified.

##### Background

During and after World War II, the Federal Government experienced severe administrative problems because it lacked a centralized method of procurement, utilization and disposal of supplies and property. On the recommendation of the first Hoover Commission, Congress created GSA under the Federal Property Administrative Services Act of 1949 to solve these problems. Section 2 of the enabling legislation describes GSA's mission:

"to provide for the Government an economical and efficient system for (a) the procurement and supply of personal property and nonpersonal services, including related functions ... (b) the utilization of available property (c) the disposal of surplus property and (d) records management."

In addition, the Act allowed the Administrator of the agency to determine when it would be advantageous to the Government for GSA to perform directly centralized services and procurement and the extent to which GSA should supervise these activities by Federal agencies.

At the time of its creation, GSA consisted of three bureaus which were transferred from other areas of the Federal Government. The Public Buildings Service was transferred from the Federal Works Agency, General Supply was transferred from Treasury, and National Archives was added.

Since 1949, the following service areas were added to GSA: Transportation and Public Utilities Service (TPUS), formed in 1955, to operate the interagency motor pool, provide traffic management and represent the Federal Government in public utilities contract negotiations and disputes; Automated Data and Telecommunications Service (ADTS), established in 1972, to manage voice and data transmission; Federal Property Resources Service, established in 1978, to manage the utilization and disposal of Federal real and personal property.

Total civilian procurement in 1981 was \$29.7 billion. Of this total, GSA was responsible for 10.4 percent or \$3.1 billion in expenditures.

The following provides examples of GSA's activities:

- o Manages 230 million square feet out of 3 billion square feet operated by the Federal Government.
- o Manages about 90 thousand vehicles, or 21 percent, of total Government vehicles.
- o Responsible for \$540 million, or 25 percent, of annual ADTS expenditures in the civilian sector.

GSA influences all civilian procurement through its policymaking authority. GSA establishes such procurement policy in two basic ways: by establishing regulations for procurement practices, and by mandating when GSA is the required source of supply for procurement needs.

The Administrator of GSA, through the Office of Acquisition Policy, issues Federal Procurement Regulations (FPR). The FPR establishes procurement policy guidelines for the bureaucracy to use in procurement activities. Civilian agencies can supplement these regulations with departmental rules, but they must not conflict with the FPR.

In addition, the Administrator has the authority to mandate with some exceptions, most notably related to the Department of Defense (DOD), when GSA is the required source of supply for Federal procurement needs. For each program, the Administrator may require Federal agencies to purchase items from GSA or specify eligible vendors for the Government's procurement needs. For example, both Federal Supply Service (FSS) and ADTS establish a mandatory list of eligible vendors for supply needs.

GSA has had a rapid turnover of executives. Since 1969, GSA has had nine Administrators and ten Deputy Administrators. The average term of service has been 18 months and 14 months, respectively. The same problem exists with regard to the Service Commissioners, most notably in FSS. FSS has had 14 Commissioners during the same time frame.

#### Methodology

The research conducted for this issue was a combination of interviews within GSA and with other Government agencies, reviews of various papers and studies (a particularly excellent paper is "Evaluation of the General Services Administration" dated December 31, 1980 by the National Academy of Public Administration), and Task Force observations concerning the efficiency of the current GSA organization.

#### Findings

GSA manages and supplies only a portion of Government procurement of items which would normally fall within the scope of such an agency. GSA operations labor under a number of handicaps inherent to its mission and current organizational structure, namely:

- o The Administrator does not hold cabinet rank, yet is charged with the responsibility of setting policy and regulations which govern the actions of cabinet members. This undoubtedly inhibits some initiatives.
- o Unlike most other Government agencies, GSA does not serve a constituency outside the Government and therefore lacks a group to champion its cause in the other branches of Government.
- o A large portion of its efforts are devoted to performing mundane tasks such as maintenance, janitorial services, and motor pools -- lacking the glitter of space exploration or the fundamental requirements of the defense of the country.

A major contributor to the difficulties at GSA has been the lack of continuity and relevant experience of senior management. Considering the time needed for senior managers to become acclimated to the complex environment of GSA, and then the interval required for plans to be put

in motion, it is apparent that just at the moment when one management approach begins to move forward, it is replaced by either new objectives or a new learning curve. While it is difficult to quantify, this "turnstile" management has significantly lessened the efficiency of GSA. A constantly recurring theme during interviews concerning the procurement and distribution processes has been the uneven performance of GSA.

At this time, there are four principal courses of action concerning improvements to GSA that were advocated by the interviewees:

- o begin anew -- go back to the original 1949 mandate;
- o disband GSA;
- o make minor modifications to GSA; or
- o reconstitute the GSA -- separate the policy and service function.

#### Conclusions

While GSA has accomplished much in a constantly expanding and changing customer environment, it has not achieved all of the expectations contained in the 1949 mandate.

The Task Force considered each of the possible courses of action that were discussed in the interviews, and with respect to each concluded the following:

- o Begin anew-- go back to the original 1949 mandate -- while some interviewees have indicated this option as not only desirable but also achievable, we do not believe this is a realistic approach. The problems of the past are real, and there is no assurance that GSA has the energy (without additional resources added) or capacity to make the changes and maintain the management consistency which would be necessary to overcome the reputation it has developed over the past thirty years.
- o Disband GSA -- advocates of this option argue that each agency understands its needs and requirements best and GSA can only hinder their mission. We do not accept this argument because



we see the need for a strong central group which would articulate the "do's" and "don'ts" in the field of procurement and logistics to limit the number of uninformed decisions. Other Government agencies also have significant turnover at the senior management level, and Government procurement in the aggregate is too large to have each agency setting its own policies.

Another factor to be considered is the cost of foregoing "economies-of-scale." Lastly, the basic mission of other Government agencies should not be diluted or detracted by repetitive administrative functions; and a central support unit with the requisite expertise is one possible solution.

- o Minor modification to GSA -- this option is essentially "business-as-usual," with a few suggestions and changes coming from the various task forces. We have rejected this approach mainly because we feel the problem is too critical, and too much is at stake, to pretend that things somehow will improve.

This brings us to the last option, which is the Task Force's preferred option:

- o Reconstitute the GSA - separate the policy and service function -- when policy and service functions are combined in one unit -- where there is no unifying discipline such as a "bottom line" -- the unit seems to divide the two functions into discrete areas and then vacillate between the two responsibilities, depending on the mood of management and/or the resources (i.e. budget) available. This appears to have been the history of GSA over the recent past, and both "policy" and "service" have suffered. The Office of Federal Procurement Policy (OFPP) was created mainly due to the perception that a coherent Government policy was lacking in procurement. The low level of GSA's market share is a direct result of poor service. Wanting better results will not cure these two problems -- steps have to be taken to divide the responsibilities and focus attention on each separately to monitor performance.

### Recommendations

Based on the findings and conclusions stated above, and findings and conclusions stated in our discussion papers on the role of the OFPP, centralization versus decentralization, and the FSS, we have adopted the last option as the most preferred and have developed the following recommendations.

PROC 14-1: Separate the policy and service functions currently in GSA. Policy responsibilities should be transferred to OFPP, under the aegis of the Office of Management and Budget, which would set broad procurement, contracting and inventory policy for Government agencies. An integral part of this group would be a council of Government agencies which would participate in the formulation of procurement policy with a continuing mandate, rather than being task-oriented, as appears to be the case today.

The implementation of procurement policies in the civilian sector would essentially be the sole responsibility of GSA. Also, "norms-of-service" (i.e. level and types of service to be provided by GSA) would be agreed upon and publicized. This would close the link between resources available (i.e. budget, headcount) and efficiency. If the budget were reduced, everyone concerned would understand the effect on service and conversely if the requested resources were provided, all would know what level of service to anticipate.

PROC 14-2: To ensure the greatest possible "economies of scale," direct all Government agencies to use GSA for procurement, with the following exceptions:

- o procurement for defense of the country;
- o procurements that could be centralized by other civilian agencies to capitalize on expertise already in place (for example, Veterans Administration purchasing medical supplies); and
- o clearly understood and previously agreed upon procedures allowing agencies to go to the open market if GSA was unable to meet their needs, or if it was determined to be less costly.

### Savings and Impact Analysis

Since this issue deals essentially with management and organizational structure, the savings analysis would require an in-depth study, beyond the time and resources of this Task Force. Cost savings, however, are believed to be substantial, and secondary benefits including improved morale and effectiveness would be achieved.

### Implementation

To create the desired stability, experienced qualified personnel are needed for senior management, and the Administrator's tenure needs to be fixed at a period in excess of the President's four-year term, at least in the initial phase, to begin the necessary changes. The tenure could be changed depending on needs and circumstances in the future.

To successfully accomplish these recommendations, the following would be required:

- o Forming a group to prepare an in-depth implementation plan. We would also suggest that this group include those responsible for seeing that the plan is ultimately carried out.
- o Establishing clear and easily understood service standards for GSA which are publicized and agreed to by all concerned.
- o Creating a "feed-back" system to enable a critique of the quality of service provided by GSA.

PROC 14-1 requires action by Congress and Executive Order, with agency-level implementation. PROC 14-2 can be accomplished by the Executive Branch alone.

II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)D. CIVILIAN AGENCY ORGANIZATION (CONT'D)PROC 15: FSS REVIEWIssue and Savings

Can the organization of the General Services Administration's (GSA) Federal Supply Service (FSS) <sup>1/</sup> be improved and streamlined to make it more efficient in its mission of supplying Government agencies?

An estimated \$42 million could be saved annually as a result of Task Force recommendations with three-year savings of \$74 million.

Background

The mission of FSS is to provide an efficient and economical system for supplying executive agencies with common use items.

FSS accomplishes its mission through three programs:

- o Stock Program                      \$ 903 million      FY 1981
- o Schedules Program                \$1,214 million      FY 1981
- o Special Order Program          \$ 176 million      FY 1981

As part of its stock program, FSS currently operates 12 depots, which are primarily responsible for filling bulk quantity orders requested by agencies from catalogs. In

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<sup>1/</sup>Effective September 30, 1982, the Federal Supply Service was abolished and a new Office of Personal Property, encompassing all of the responsibilities of the Federal Supply Service and certain other responsibilities, was established. Since this study was conducted under the former organization and since the recommendations are not affected by the new organization, this report focuses on the pre-September 30th organization.

addition, FSS operates 57 self-service stores, which agency personnel visit to purchase small quantities of common use items.

FSS is experimenting with a new retail service approach with two pilot customer supply centers which service small orders that agencies phone in, mail in or walk in. FSS's primary objective with the new approach is to reach customers who currently do not have access to the self-service stores. The major difference is the addition of the phone-in/mail-in with direct delivery capability.

Organizationally, FSS is composed of five "staff" groups which establish policy and operating procedures and monitor performance and three "line" units -- the Tools Commodity Center, the Furniture Commodity Center, and the General Products Commodity Center -- which execute the programs.

During fiscal year 1981, based on dollar volumes, these three commodity centers were responsible for approximately 80 percent of the schedules program, 38 percent of the special order program, and 16 percent of the stock program. The balance is handled by GSA's Office of Operations and 11 regional offices, each of which has nationwide responsibility for particular classes of goods.

The commodity centers have more complete management responsibility for their assigned classes of goods than the regions, though not total responsibility. The Tools Commodity Center, for example, writes its specifications, does procurement, cataloging and method of supply determination, but not inventory management.

The regions' "nationwide" responsibility for class(es) of goods is primarily the contracting responsibility. Responsibility for the other aspects of commodity management may be assigned to other regions or to a central office. As an example, FSS's Office of Procurement writes all specifications for goods procured by the regions. And, although effort has been made to collocate the contracting and inventory management functions within the regions, this approach has not been fully implemented.

#### Methodology

Interviews were conducted with representatives of each of the functional units of FSS and two regional offices to understand their specific mission/role in the procurement process and their interrelationship with other units.

General Accounting Office Reports, Inspector General Reports, and other related reports were also reviewed. Additionally, civilian agencies utilizing FSS's services were interviewed.

### Findings

Although the stated objective of management is to concentrate policy development and evaluation into central office program offices (FSS) and to concentrate operations in the regional field activities, responsibility for execution of the stock, schedule, and special order programs is diffused between FSS's central office and the 11 regional offices.

The degree of responsibility for commodity management is not consistent within the commodity centers nor between the commodity centers and the regional offices. For example, unlike the Tools and Furniture Centers, the General Products Commodity Center is responsible only for the schedules program of the Federal supply classes assigned to it. Stock items within these supply classes are purchased, and inventory managed, by the National Capital Region. Additionally, commodity management for goods procured within the centers is better integrated than for goods procured within the regions.

Both within the regional offices and the commodity centers, the procurement process is subject to much internal review and oversight. In addition to the requirement that warranted contracting officers must obtain "one-up" approval before executing any contract, contracts over specified dollar thresholds must be reviewed by the Office of Project Control and Oversight [regions] or the Office of Procurement [commodity centers], the Office of Regional Counsel and GSA's Office of Acquisition Policy. Additionally, contracts are subject to review both pre-award and post-award by GSA's Office of Inspector General.

The mission of FSS is to provide an economical and efficient service to executive agencies. Yet, the key performance indicators that FSS uses to measure the effectiveness of its programs -- such as contract coverage, fill-rates, work-in-process, priority effectiveness, back orders-- are geared to the timeliness of program delivery.



An integral part of the economy and efficiency aspect of FSS's mission is to determine which of its programs -- stock, schedule or special order -- will supply the commodity at the least total cost to the Federal Government. Ideally, a method of supply (MOS) decision should be made for all new introductory items as well as periodically for existing items to validate the current method of supply. In the past, reevaluation of the method of supply for existing items appears to have received less attention than it deserved. GSA's Office of Management Improvement completed a study in May, 1982, which suggested that substantial opportunities existed to change the method of supply. FSS is currently refining the economic model it uses to analyze the method of supply and is beginning an effort to review major items in the stock program, its most resource-intensive program, to validate or change the present method.

### Conclusions

- o FSS does not appear to have any performance indicators geared to measuring improvement in the economies achieved, such as the discount negotiated in the current year versus the prior year, or to evaluating its results vis-a-vis those of the marketplace. Such indicators should be developed.
- o The GSA effort currently underway to change the method of supply for major items should be accelerated, and a specific implementation plan developed and monitored.
- o Although every organization needs internal checks and balances, this organization seems over-weighted toward supervising quality into the product by superimposing approval processes external to the responsible unit, rather than strengthening the professionalism of that unit.

Our interviews did not unearth any clear-cut intrinsic rationale supporting the current division of procurement responsibilities between the regions and the commodity centers nor the current organization of the regional procurement responsibilities. Rather, opportunity exists to consolidate the number of offices involved in contracting and inventory management.

- o FSS's Self-Service Store Program does not appear to adequately support agencies' retail supply needs. A direct delivery system appears superior to the current walk-in approach. FSS's pilot customer supply centers, although a step in the right direction, do not take the delivery approach far enough, as they maintain the walk-in capability. Furthermore FSS is limiting its options by concentrating on converting either depots scheduled to be closed or existing self-service stores to the new facilities.
- o Since FSS's retail supply activity appears to be a commercial activity in accordance with the provisions of Office of Management and Budget (OMB) Circular A-76, and since there appears to be an adequate supply of commercial sources, the Task Force believes this activity should be contracted out to the private sector.
- o The approach of a commodity center with "cradle to grave" management responsibility appears to have merit. It represents a single face, with potential for greater responsiveness, to the customer. It also represents a single organization accountable to management, with potential for increased efficiency of the procurement process, more uniform implementation of policies and procedures, better career pathing and training, and development of greater product and technical expertise.

#### Recommendations

PROC 15-1: Convert FSS to a full commodity center approach, under which each commodity center has "cradle to grave" management responsibility and is operated as a distinct cost center, as it significantly reduces the number of locations where procurement and inventory management activities are conducted. This approach will establish a single organization accountable to management for both aspects of the FSS mission -- service and economy. GSA management should restate the mission of the regions as it pertains to FSS's activities. The Task Force believes that the commodity centers as defined above should report to FSS and that with certain exceptions, such as the operation of the depots, the regional responsibilities related to FSS's mission should be curtailed.

A moratorium on further organizational changes until the commodity center approach has operated for a period long enough to evaluate its effectiveness should be issued.

Resources should be allocated from oversight activities to the commodity centers to enhance their overall professionalism.

PROC 15-2: Develop and monitor performance indicators that measure the effectiveness of the procurement function, taking into account the marketplace in addition to timeliness of delivery.

PROC 15-3: Develop a program with specific objectives and deadlines to re-evaluate the method of supply for major items. Responsibility for implementation should be assigned to the commodity manager. (The Task Force recommends significant reductions in the use of the multiple awards program. See PROC 21.)

Restructure the FSS approach to servicing agencies' retail supply needs to emphasize a delivery system. Before proceeding with the implementation of the customer supply center as currently configured, FSS should reassess its approach, determine the optimum number, locations, and mix of direct delivery facilities, and evaluate the potential benefits of converting to such a system.

PROC 15-4: Develop a program to contract out the direct delivery retail facilities to the private sector. The Task Force recommends that FSS begin with site(s) outside of the National Capital Region as a pilot program under a schedule which would result in a prompt evaluation of such an effort. To further reduce costs, FSS should undertake the A-76 cost comparison based on estimated costs of these facilities, rather than incur the implementation costs of converting the selected site(s) to the new facilities.

#### Savings and Impact Analysis

Potential annual savings of \$36 million are estimated for the improvement of method of supply. This has been determined based primarily on a 1982 study conducted by GSA's Management Improvement Office. After examining the study, GSA reduced the figures to incorporate qualitative factors not included in its calculations (the study specifically highlighted these factors). The Task Force feels the number is realistic and attainable.

An additional \$6 million in potential savings was determined for the use of direct delivery facilities. This figure was based primarily on Task Force calculations guided by OMB's A-76 Cost Comparison Handbook and the findings of a 1981 study conducted by GSA's Office of the Inspector General. The Task Force feels the number is realistic and attainable.

The projection of savings by year is:

|                  | <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> | <u>Total</u> |
|------------------|---------------|---------------|---------------|--------------|
| Method of Supply | \$10          | \$15          | \$36          | \$ 62        |
| Direct Delivery  | <u>--</u>     | <u>6</u>      | <u>6</u>      | <u>12</u>    |
| Total Savings    | <u>\$10</u>   | <u>\$ 22</u>  | <u>\$ 42</u>  | <u>\$ 74</u> |

#### Implementation

Each of the recommendations can be implemented by GSA management.

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### E. PROCUREMENT EFFICIENCIES (CONT'D)

#### PROC 18: PRIVATE SECTOR GOODS AND SERVICES

##### Issue and Savings

Are there savings to be realized through improving the implementation of the policies and procedures for determining Government's use of the private sector, as directed in the Office of Management and Budget (OMB) Circular A-76?

More focused attention on the implementation of the policies in the circular could result in increased annual savings in excess of \$726 million for defense and civilian agencies combined by fiscal 1987. Three year cost savings are projected to be \$1,176 million

##### Background

OMB Circular A-76 defines the policies and procedures to be followed in determining whether a certain commercial activity should be carried out by the Government or private enterprise. A-76 pertains to commercial and industrial activities currently performed by Government employees such as food service, maintenance, security, fire-fighting, laundry and dry cleaning, etc. It does not apply to major systems acquisitions or inherently Governmental functions of agency administration and management. Moreover, no Government agency may convert its commercial and industrial activities to contract if a review indicates that: no satisfactory commercial source is available, the activity relates to national defense, or the private source results in higher costs. When A-76 contracts expire, they are reviewed to determine if they should be brought back in-house.

A series of directives ranging from Bulletin 55-4 (January 1955) to OMB Circular A-76 (revised in March 1979) have articulated Government views on this policy and directed agencies on its application to their commercial and industrial activities which, in 1981, were valued at over \$5 billion.

Since 1979, detailed and time-consuming procedures have been used for developing cost comparisons of commercial and industrial activities performed in-house and in the private sector. Depending on the complexity of the activity and whether there are appeals, the process typically takes from 9 to 24 months. Before an in-house activity can be converted to contract, a savings of at least 10 percent of the in-house personnel costs must be demonstrated in the cost comparison. Government costs include contract administration and employee benefits.

Should the activity be contracted out, military personnel are reassigned while displaced civilian employees of the Department of Defense (DOD) and other executive agencies are accorded the first right of refusal for employment on the activity with at least the wages and fringe benefits prevailing for similar work in the locality. Displaced employees are also given priority consideration and training for other Government positions.

If the activity remains in-house after a cost comparison study, substantial cost savings may result from the streamlining or "management review" process (especially within DOD). Where such management reviews are obligatory, there is ample evidence of savings for the period FY 1979-1981. Among the civilian agencies, by contrast, data on streamlining savings are scarce owing to both the paucity of A-76 studies for fiscal years 1979-1981 and the inconsistent application of management reviews. Under the present circular, streamlining is encouraged but not required for civilian agencies.

While DOD has led other agencies in the implementation of the A-76 program, it has been subject to Congressional restrictions and requirements not imposed on civilian agencies. Civilian agencies need no cost studies to contract out when the annual operating costs are under \$100,000 while DOD has no cost study threshold. Congress requires that DOD report activities that are scheduled for contracting out and provide details of cost study results after completion. In addition, DOD is required to present annual reports to Congress on its contracting-out efforts.

The DOD A-76 program suffered a setback when Congress passed a moratorium on A-76 reviews for FY 1978. In August 1982, a joint conference committee of the House and Senate passed a DOD restriction forbidding the authorization of appropriation funds in connection with any new A-76 study between October 1, 1982, and March 31, 1983. DOD also was forbidden to enter into any new contract



for the performance of fire-fighting or security-guard functions on any military bases or facilities during FY 1982.

The current Administration has encouraged OMB to give contracting out more prominence. The President affirmed his support for this program in his 1982 Budget Message, and OMB is in the process of simplifying the A-76 cost comparison procedure.

### Methodology

Task Force findings are based primarily on interviews with Government officials and the General Accounting Office (GAO) analysts. The Federal Acquisition Institute and GAO provided most of the necessary background material on the progress of A-76 reviews over the past three years. Copies of OMB Circular A-76 and supporting documents were obtained from OMB and the executive agencies.

### Findings

Since the moratorium of FY 1978, the DOD has performed cost comparison studies of commercial activities involving 17,600 personnel spaces. These studies resulted in a determination that it was more economical to contract approximately two-thirds of the activities to private industry, resulting in the conversion of 11,700 spaces to contract with an annual savings of approximately \$70 million. During the same period, DOD streamlined the activities which remained in-house for an additional savings of \$14 million.

Implementation of the A-76 program among civilian agencies has been hampered by chronic delays and confusion. There are preliminary indications that A-76 reviews within the civilian agencies result in a ratio of savings comparable to those achieved by DOD; however, no more than a few dozen cost studies have been completed since 1979 and data on total savings for all civilian agencies are not available.

Recent interviews with Office of Federal Procurement Policy (OFPP) representatives and A-76 coordinators indicate the following:

- o An agency perception that A-76 is not a serious policy due to inconsistent support from successive Presidential Administrations and opposition within Congress.

- o Insufficient familiarity with the status of A-76 implementation efforts by agency coordinators.
- o Inadequate training for personnel conducting cost studies and independent reviews.
- o Resistance from managers and staff conducting cost studies who perceive a loss of job security or possible demotion if their operation is contracted out.
- o Complex, time consuming, and cumbersome procedures for A-76 cost comparison studies as detailed in the Handbook issued by OMB (1979).
- o Lack of communication between OFPP and A-76 coordinators for periods ranging from 6 months to a year. Most of OFPP's efforts on the last year appear to have been directed toward the revision of the 1979 Cost Comparison Handbook.
- o Concern over Congressional opposition leading to OMB delays and a concomitant reduction in savings. For example, the General Services Administration (GSA) requested a waiver from OFPP on cost studies of its in-house custodial activities because extensive experience with contractors pointed to assured savings by converting to contract. OFPP representatives report that the waiver was withheld because of anticipated Congressional and civil service opposition. As a result, GSA estimated it will spend \$1 million on in-house custodial reviews.

### Conclusions

The above observations have led the Task Force to conclude that the civilian agencies have not appropriately supported A-76 directives and may lack the motivation necessary to effectively implement the program.

Further, the inadequate training of personnel conducting cost studies, coupled with the cumbersome procedures for the studies, contribute to lack of implementation.

These problems require management attention, some automation of procedure, and on-going support from OMB in order to remedy the current situation.

One way to institutionalize the proper implementation of A-76 would be a linkage of budget allocations to compliance with A-76 guidelines.

### Recommendations

PROC 18-1: Mount a campaign through OFPP, the executive agencies, and private industry to gain support for the A-76 program from Congress, the public, Government unions, and local governments. The campaign would highlight the positive aspects of the program such as protective employment provisions, increases in local tax bases, and revenues from the private contractor. Moreover, accurate and complete data on net A-76 savings from each civilian agency must be collected in order to demonstrate the value of A-76 reviews.

PROC 18-2: Raise the present cost study threshold to 10 full-time employee equivalents, approximately \$250,000, and have the threshold applicable in both DOD and civilian agencies. This would avoid the need for elaborate cost studies for activities involving lesser amounts.

PROC 18-3: Streamline cost study procedures through the development of more standardized performance work statements and study the use of computer processing to automate the cost calculations.

### Savings and Impact Analysis

Combined DOD and civilian agencies savings are estimated to be \$726 million annually. The potential increased savings figure for DOD was based on estimates obtained from DOD's Base Operations Directory Facilities Office, Environment and Economic Adjustment, Military Reserve Affairs and Logistics (MRA&L). The potential increased savings figure for civilian agencies was based on data obtained from OFPP. After reviewing this source material, the Task Force concluded that the findings were appropriate and the projected savings are reasonable.

Projected cost savings by year are:

|              | (\$ millions) |               |               |              |
|--------------|---------------|---------------|---------------|--------------|
|              | <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> | <u>Total</u> |
| Cost Savings | \$120         | \$330         | \$726         | \$1,176      |

### Implementation

The Administration should mount the campaign to gain support for the A-76 program through Executive Order. The additional recommendations can be accomplished at the

agency level through the direction of the central oversight agencies.

Develop plans for accelerating the application of the A-76 program at DOD. Consideration should be given to the development of motivations and incentives to encourage support and active participation for the A-76 program from a top-down perspective within the Military Services. This would supplement the current program of rewarding the attainment of improved efficiencies, in part from A-76 studies, from an allocation of 2,000 personnel spaces.

Enhance OFPP efforts to guide and monitor agency progress in implementing A-76 reviews, in order to counter widespread indifference to A-76 objectives. The Office of Federal Procurement Policy Acts of 1974 and 1979 have already provided OFPP with a clear mandate to assume these oversight responsibilities.

At least one meeting should be held annually among OFPP representatives and A-76 coordinators to present status reports on Defense and civilian agency implementation efforts. In addition to arranging for an annual A-76 meeting, OFPP should maintain regular and thorough consultation with A-76 coordinators and require periodic progress reports from Department Secretaries.

We endorse the OFPP proposal to require management reviews for each cost comparison performed by the civilian agencies in order to achieve additional savings and stimulate greater Governmental efficiency.

Intensify efforts at OMB to implement Circular A-11 ("Preparation and Submission of Budget Estimates") linking budget allocations to civilian agency compliance with Circular A-76.

OFPP should assist civilian agency coordinators with the development of procedures linking intra-agency budgets to A-76 guidelines particularly at the bureau and regional levels.

Provide for recognition and rewards to those managers who show initiative in their conduct of A-76 reviews. The Office of Personnel Management should issue directives in this regard.

Increase executive attention on civilian agencies to accelerate their A-76 implementation efforts and to monitor the progress of cost comparison studies.

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### E. PROCUREMENT EFFICIENCIES (CONT'D)

#### PROC 20: CENTRALIZATION VERSUS DECENTRALIZATION

##### Issue and Savings

What are the cost savings to be realized through some increased centralization of the procurement of goods and services?

Our analysis indicates that the Government could save up to \$242 million a year by increased centralization of civilian agency procurement of "common use" items. Three-year cost savings, after implementation costs, amount to \$312 million.

##### Background

One of the main reasons that organizations centralize purchasing operations is to gain economies from aggregated purchases. Item-by-item analysis of the cost of only procurement will usually indicate that more centralization is better than less. However, increasing centralization often leads to a decline in effective servicing and distribution -- i.e., unacceptable products/services delivered to client agencies.

To resolve and maximize the trade-off between economy and service quality, centralization is normally limited to an organization's "common use" items.

Unfortunately, the term "common use" is not easy to define operationally. While office supplies are classified as common use in most organizations, certain kinds of bullets may represent common use items to the military and specialty items to an agency such as the Department of Agriculture.

In fiscal year 1981, total Government procurement as reported by the Federal Procurement Data System (FPDS) was \$134.5 billion. Purchases of common use items were estimated by the General Services Administrations (GSA) Office of Policy and Aging Assistance (OPAA) at \$14.9 billion.

The study found that GSA's share of the \$14.9 billion was \$5.2 billion, or 35 percent. The breakdown is as follows:

Government Procurement of (GSA) Common Use Items<sup>1/</sup>  
( \$ Billions)

|                      | <u>Total</u> | <u>DOD</u> | <u>Civilian</u> | <u>GSA Share</u> |            |                 |
|----------------------|--------------|------------|-----------------|------------------|------------|-----------------|
|                      |              |            |                 | <u>Total</u>     | <u>DOD</u> | <u>Civilian</u> |
| Services             | \$ 5.6       | \$1.3      | \$4.3           | \$2.0            | \$0.4      | \$1.6           |
| Supplies<br>& Equip. | 2.9          | 1.2        | 1.7             | 1.4              | 0.6        | 0.8             |
| Under<br>\$10,000    | <u>6.4</u>   | <u>3.4</u> | <u>3.0</u>      | <u>1.8</u>       | <u>1.3</u> | <u>0.5</u>      |
| Total:               | \$14.9       | \$5.9      | \$9.0           | \$5.2            | \$2.3      | \$2.9           |

GSA Share of Government Procurement  
of Common Use Items

|                 | <u>Total</u> | <u>DOD</u> | <u>Civilian</u> |
|-----------------|--------------|------------|-----------------|
| Services        | 36%          | 31%        | 37%             |
| Supplies Equip. | 48%          | 50%        | 47%             |
| Under \$10,000  | 28%          | 39%        | 17%             |

<sup>1/</sup> Excluded from the common use category were all purchases of research and development (R&D) (\$16.1 billion), purchases of services not related to GSA purchased products (\$34 billion) and purchases of products specific to the operation of particular agencies, such as spacecraft for the National Aeronautics and Space Administration, or grains and meats purchased by Agriculture under its commodity price support activities (\$69.5 billion). Included are such items as office equipment and supplies, hand tools, certain automated data processing (ADP) equipment, certain building maintenance services, etc.



GSA's share as calculated above excludes the centralization of Government procurement within the Department of Defense (DOD), provided by the Defense Logistics Agency (DLA) for the military. DLA also provides some common use items to civilian agencies, although the volume is small.

The Government has long wrestled with the question of how to organize and conduct Government procurement to balance the economy gained in centralizing procurement against the effectiveness lost by "line" agencies.

Most major organizations, the Government included, have evolved to a pragmatic mix of centralized and decentralized purchasing, i.e., some items are purchased centrally and some locally. Where this evolution is characterized by turf squabbles, politics, personality clashes, et cetera, the resulting mixture is not likely to be either economic or effective. For this reason, most large private sector organizations have established functional or matrix reporting relationships for decentralized purchasing personnel.

In a functional or matrix organization, decentralized personnel report both to the line managers they support and to a central purchasing office. The central purchasing office is responsible for functional integrity, seeing that policy is followed and overseeing the implementation of functionalization. Having a functional organization is important for ensuring that the centralization question is monitored on an ongoing basis and that decisions are properly implemented and are not side-tracked by bureaucratic politics. The operating units are responsible to see that decisions are implemented while missions are accomplished.

#### Methodology

The Task Force searched published sources for relevant information regarding the centralization of procurement. Interviews and briefings were conducted throughout the GSA, with other agencies, and with private sector firms.

The recommendations are designed to bring the centralization of Government procurement toward what is found in the private sector.

#### Findings

In most cases civilian agency procurement activity is decentralized, resting with program units. For example, in the Department of Agriculture, ADP equipment is procured

centrally and all other items (common use and specialty) are procured by program units. The Department has over 4,000 offices throughout the country having some degree of procurement authority.

Federal Supply Service (FSS) and OPAA have tried to identify what proportion of Government procurement, as reported by the FPDS, might be "effectively and economically" provided by GSA. In addition, the study determined to what degree the procurement of these items is currently centralized under GSA.

A pilot study is underway that should help begin to answer questions about which particular items should be procured centrally and about how they should be provided -- through GSA's stores program, its depots, its schedules program, or some other route. The study is being undertaken by GSA and the Department of Commerce (DOC). The study is supposed to identify exactly what the DOC is buying and at what price and to determine which items GSA can provide more economically and effectively.

One concept of increased centralization that has been proposed is merging GSA's FSS into DLA. This possibility was examined; however, it was concluded that the consolidation of civilian agency procurement activities into FSS and the consolidation of DOD consumables into DLA offered higher priority cost savings opportunities at this time.

### Conclusions

More work needs to be done to identify which items represent common use items for the Government and should be procured centrally. While we might not agree with the classifications of particular items in OPAA's study, the finding that \$14.9 billion of Government procurement represents purchases of common use items appears conservative. Accepting the \$14.9 billion estimate, the degree of centralization of these items as represented by GSA's share should be higher.

The study underway with GSA and DOC is an important first step for identifying what specific items should be provided to DOC by GSA and how. Similar studies must be performed with each agency to completely identify the magnitude of the opportunity for increased centralization of civilian agency procurement.

The Government has not attempted to establish a formal functional organization for purchasing. Having a functional organization in place which could monitor and support the development and implementation of procurement policy would make much easier any centralization of line procurement activity.

#### Recommendations

PROC 20-1: Increase the centralization of civilian agency procurement. We endorse the effort underway between GSA and DOC as being the best way to begin to identify which items should be procured centrally. We encourage both parties to be as thorough and as swift as possible, and we recommend that GSA conduct similar studies with other major agencies as soon as possible.

#### Savings and Impact Analysis

The \$242 million potential savings figure was based primarily on range estimates obtained from FSS, Automated Data and Telecommunications Service (ADTS), and Public Buildings Service (PBS). Of the \$242 million, approximately 40-50 percent comes from FSS items, 25-30 percent from ADTS items, and the remainder from PBS items. After examining the data, it was decided that the low end of each range would be most appropriate. The Task Force feels the savings are attainable.

Implementation costs are estimated to total less than \$80 million.

Three-year cost savings by year are:

|                     | (\$ millions) |               |               |              |
|---------------------|---------------|---------------|---------------|--------------|
|                     | <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> | <u>Total</u> |
| Cost savings        | \$40          | \$110         | \$242         | \$392        |
| Implementation cost | <u>(80)</u>   | <u>-</u>      | <u>-</u>      | <u>(80)</u>  |
| Net cost savings    | (\$40)        | \$110         | \$242         | \$312        |

Implementation

To successfully implement increased centralization, GSA must increase coverage of items in its stock program, increase coverage of items under its schedule program, and exert its mandatory sourcing power. For further discussion of related matters, See PROC 10 concerning the role of the General Services Administration and the Federal Supply Service.

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### E. PROCUREMENT EFFICIENCIES (CONT'D)

#### PROC 22: ENHANCING COMPETITION

##### Issue and Savings

What actions can be taken to make procurement more efficient by enhancing competition and simplifying the process?

By simplifying the procurement process through more extensive use of functional and simplified specifications, the Government can save an estimated \$72 million per year on purchases made by civilian agencies alone.

##### Background

The initial starting point for any procurement action is when a user identifies a need or requirement. The next step is for the Government to specify to possible suppliers or contractors this need. At this point, the basic document is a Federal specification of some type.

The Government uses many specifications ranging from simple two- or three-line brand name descriptions to functional specifications that describe the desired performance to detailed technical specifications that delineate not only the performance but the methodology of manufacture, materials, and production data. Historically, the Government has tended to describe its needs in technical terms. For example, a typewriter ribbon specification contains nine pages of details plus a five-page amendment. Describing the same item in commercial terms using a commercial item description takes two-thirds of a single page.

This tendency toward complex procurement documents was recognized by the 1972 Commission on Government Procurement which concluded that its analysis "...indicate(d) the need for a shift in fundamental philosophy relative to commercial product procurement." In the mid-1970s, a program for acquiring and distributing commercial products

was implemented. This program was designed to take advantage of the innovation of the commercial marketplace and to avoid having the Government develop or contract for unique items when commercial items were readily available.

The Task Force's analysis of this issue centers on the use of simplified Government specifications to state user needs and to lessen the administrative burden of developing, maintaining, and using detailed Federal specifications in the procurement process.

#### Methodology

Potential cost savings were developed by comparing the cost of procurements using simplified descriptions with the cost of using detailed specifications. Additionally, interviews were conducted with procurement officials in civilian and defense agencies.

#### Findings

The Task Force found that the most prevalent philosophy regarding simplified specifications within agencies was that no single type can be effective across all applications.

The formal program for acquiring commercial items and developing simplified specifications started well but has lagged since 1980-81. Within the approximately 4,100 Federal non-military specifications, only 1,023 commercial item descriptions have been developed.

The Department of Defense (DOD) has developed 355 simplified descriptions and has purchased \$256 million under the simplified specifications. Current DOD policy calls for using private sector standards and then commercial item descriptions before resorting to tailored military or Federal specifications.

In the General Services Administration (GSA), the attitude to develop simplified and commercial items descriptions has been inculcated, but resource and staff constraints have caused a slowdown in the development of new versions. Plans are being developed for fiscal year 1983 that should restart programs to reduce detailed specifications.



### Conclusions

Additional emphasis on the use of commercial products and simplified specifications is needed. While the program had a successful start it does not appear to have continued at the pace of 1980-81.

Executive Order 12352 dated March 17, 1982, is a step in the right direction. In that directive a major emphasis was to:

seek to improve competition by such actions as eliminating unnecessary Government specifications and simplifying those that must be retained, expanding the purchase of available commercial goods and services, and where practical, using functionally-oriented specifications or otherwise describing Government needs so as to permit greater latitude for private sector response.

The Administration has taken further action to put in effect the Executive Order and has formed six inter-agency task groups to develop specific implementation plans and programs. It is important to note that these task groups are directed toward implementation, not further study. One task group has as part of its charter reviewing commerciality in procurement and simplification of specifications.

### Recommendations

PROC 22-1: Start a comprehensive program with specific implementation plans and target dates for completing the shift to simpler specifications where warranted. The milestones should be geared to normal review/renewal of existing and new specifications and contracts rather than monthly or quarterly quotas.

The use of simplified specifications must become a part of the operating procedures of Government procurement. Detailed tracking and analysis should be made a part of the milestone-oriented program recommended above and should not focus on review of past activities.

### Savings and Impact Analysis

The potential savings of \$72 million per year is based upon the assumption that at least half of the existing civilian agency detailed specifications could be converted to simplified descriptions. Some further potential undoubtedly exists in DOD which is farther along in this effort in this area.

This estimate depends upon savings that would accrue from lower contract prices resulting from using simplified specifications rather than detailed Federal specifications. The estimate results from applying a 5 percent to 7.5 percent savings factor to those procurements assumed to switch to simplified specifications.

The \$72 million potential savings figure was based primarily on range estimates obtained from the Office of Federal Procurement Policy (OFPP) and interviews conducted with the Federal Supply Service, the Department of Agriculture, and the Veterans Administration. After examining the data, it was decided that the low end of OFPP's range would be used to be conservative. The Task Force feels the savings are attainable and possibly may be exceeded. The three-year savings by year are:

|              | (\$ millions) |               |               |              |
|--------------|---------------|---------------|---------------|--------------|
|              | <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> | <u>Total</u> |
| Cost savings | \$15          | \$44          | \$72          | \$131        |

#### Implementation

DOD and GSA should start the program.

Implementation does not require Congressional approval or legislative changes. The Executive Branch has already taken implementing actions through the promulgation of the previously mentioned Executive Order in March 1982.

EXCERPTS FROM THE  
PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL

REPORT ON  
THE OFFICE OF THE SECRETARY OF DEFENSE

APPROVED BY THE SUBCOMMITTEE FOR THE  
FULL EXECUTIVE COMMITTEE, SPRING-FALL 1983



## THE PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL

September 15, 1983

The Honorable Ronald Reagan  
President of the United States  
The White House  
Washington, D.C.

Dear Mr. President:

The following Report represents the results of the Office of the Secretary of Defense Task Force of the President's Private Sector Survey on Cost Control in the Federal Government. The Task Force was chaired by Robert A. Beck, Chairman and CEO, Prudential Insurance Company of America; Carter L. Burgess, Chairman, Executive Committee, Foreign Policy Association; James E. Burke, Chairman and CEO, Johnson and Johnson; and Carl D. Covitz, President, Landmark Industries, with William H. Tremayne serving as Project Manager. The Report culminates the combined efforts of over 45 members of the Task Force, who devoted about 160 person-months of pro bono work to the PPSSCC initiative. A list of all Task Force members is enclosed with this letter.

The Report on the Office of the Secretary of Defense contains major recommendations which, when fully implemented, could result in three-year cost savings of \$44,756 million. It should be noted, however, that some of the recommendations may require several years for the savings to be realized. While all facets of the Office of the Secretary of Defense could not be surveyed in the time allotted, areas selected for review were considered to offer significant potential for cost control and improved efficiency. The importance of the accompanying recommendations rests on the fact that they represent the potential for better utilizing finite resources available to the Federal Government.

Clearly, other opportunities for cost savings and revenue generation exist but, due to limited time and personnel resources, they could not be pursued. Several are suggested for further review because they offer future potential savings and revenue opportunities.

On behalf of the Co-chairs and the members of the Task Force, I would like to express our deep appreciation for the opportunity to have been of service to you and the members of your Administration.

Respectfully,

A handwritten signature in dark ink, appearing to read "J. Peter Grace".

J. Peter Grace  
Chairman, Executive Committee

## II. ISSUE AND RECOMMENDATION SUMMARY (CONT'D)

### A. LOGISTICS (CONT'D)

#### OSD 7: DOD IMPLEMENTATION OF OMB CIRCULAR A-76

##### Summary Recommendation

The Department of Defense (DOD) should seek legislation that will terminate existing constraints on DOD implementation of the Office of Management and Budget (OMB) Circular A-76. A-76 is a Government-wide cost reduction incentive program which encourages Government agencies to contract out when the private sector can provide certain goods and services more economically. In recent years, DOD efforts to implement OMB Circular A-76 have been restricted by various legislative requirements. DOD should be permitted to aggressively pursue cost savings opportunities which are available through A-76 programs.

##### Financial Impact

\$337 million  
annually

Potential Savings: DOD should be allowed to proceed with an optimum strategy for contracting out and streamlining in-house work. If our recommendations are implemented over a five-year period, annual savings of \$337 million will be realized.

### Background

OMB Circular A-76 implements the general policy that the Government should rely on the private sector to provide goods and services when it is economical to do so. More specifically, OMB Circular A-76 defines the policies and procedures to be followed in determining whether a certain commercial activity should be carried out by the Government or by private enterprise.

Circular A-76 does not apply to major systems acquisition or agency administrative and management functions. It does apply to commercial and industrial activities currently performed by Government employees, such as food service, maintenance, security, firefighting, laundry and drycleaning, automatic data processing, health services, audiovisual support, etc. The exceptions under which the Government may operate these commercial activities are: (1) there is no satisfactory commercial source available; (2) use of a private source would threaten national security; or (3) use of a private source would result in higher costs. When A-76 contracts expire, they are reviewed to determine whether they should be brought back in-house.

If a DOD activity is contracted out, military employees are reassigned. Civilian employees must be provided with the first right of refusal for employment on the contract, with at least the wages and fringe benefits prevailing for similar work in the locality. Displaced employees are also given priority consideration and training for other Government positions.

### Methodology

The Task Force findings are based on interviews with numerous Government officials and a comprehensive analysis of reports, studies and audits performed by Government and non-Government groups on contracting out under OMB Circular A-76. Interviews were conducted with officials from the Office of the Secretary of Defense (OSD), the services, and the Office of Federal Procurement Policy.

This issue and issues relating to it were reviewed by other President's Private Sector Survey task forces. For further information, refer to the reports of:

- o Procurement/Contracts/Inventory Management Task Force,
- o Real Property Management Task Force,



- o Air Force Task Force,
- o Army Task Force, and
- o Personnel Task Force.

### Findings

DOD has led other agencies in the implementation of the A-76 program. Since 1979, DOD has performed cost comparison studies of commercial activities involving 17,600 personnel spaces. These studies resulted in a determination that it was more economical to contract out approximately two-thirds of the commercial activities to the private sector. This resulted in the conversion of 11,700 spaces from DOD to private contractors, with an annual savings of approximately \$70 million. Even if an activity remains in-house after a cost comparison study, there appear to be substantial cost savings as a result of improved efficiencies (or streamlining) in operations which are identified in the cost comparison studies.

However, DOD has been subject to Congressional restrictions and requirements not imposed on civilian agencies. For example, Congress passed a moratorium on DOD A-76 reviews for fiscal year 1978, which essentially halted A-76 planned conversions for a year. Also, DOD is required to follow certain lengthy study procedures which do not apply to civilian agencies. Before an activity can be contracted out, DOD must perform a cost comparison study in which it must be demonstrated that contracting out to the private sector should yield a savings equal to at least 10 percent of the in-house personnel costs. Completion of such studies, in some cases, takes from 12 to 24 months. By contrast, civilian agencies need no cost studies to contract out activities with annual operating costs under \$100,000. In addition, Congress requires that DOD report activities which are scheduled for contracting out and also requires details of cost study results after completion. DOD must also provide annual reports to Congress on its contracting out efforts.

In August 1982, language was included in the DOD Authorization Act for FY 1983, 97-252, which prohibits any DOD expenditures on new A-76 cost comparison studies through March 31, 1983. DOD is also prohibited in FY 1983 from entering into any new contracts for firefighting or security guard duties on any military installation.

The Administration has encouraged OMB to give more emphasis to contracting out programs. The President affirmed his support for this program in his March 1982 budget message. It is our understanding that OMB is currently working on a simplification of A-76 cost comparison procedures.

### Conclusions

DOD efforts to aggressively pursue savings opportunities under the A-76 program have been constrained by legislatively imposed restrictions and requirements. Continual intervention in DOD's management of the program disrupts the contracting process and discourages support for active participation in the A-76 program within the services.

### Recommendations

OSD 7-1: Current restrictions on DOD's use of A-76 procedures should be removed. DOD should be permitted to program optimum savings under A-76 procedures without the constraints which destabilize the A-76 effort. DOD is currently subject to additional requirements which have the net effect of reducing potential savings. To the extent that restrictions on DOD's implementation of A-76 have become permanent through their inclusion in appropriation or other legislation, DOD should seek further legislation to repeal these restrictions.

### Savings and Impact Analysis

The OSD Task Force understands that DOD objectives for FY 1982 to 1987 were for conversions of approximately 78,400 personnel spaces to private contracts and streamlining of 2,500 additional spaces. Projected savings were \$766 million per year. Operating under existing legislative restrictions, DOD expects that actual conversions and streamlining during the period will effect a total of approximately 45,000 personnel spaces for annual savings of \$429 million. If these restrictions on DOD's use of A-76 procedures were removed, DOD would save an additional \$337 million. This would bring total savings from A-76 to the originally planned \$766 million.

Exhibit II-3, at the end of this issue, provides details on expected A-76 conversions versus actual conversions and in-house streamlining. The incremental

savings attributable to full implementation of expected A-76 conversions is approximately \$337 million by FY 1987 (five years).

The estimated savings for the first five years from implementation of the recommendations would be:

(\$ millions)

|                  |              | Assuming 10 percent<br>inflation |
|------------------|--------------|----------------------------------|
| First year       | \$ 67        | \$ 67.0                          |
| Second year      | 135          | 148.5                            |
| Third year       | 202          | 244.4                            |
| Three-year total | <u>\$404</u> | <u>\$459.9</u>                   |
| Fourth year      | 270          | 359.4                            |
| Fifth year       | 337          | 493.4                            |

#### Implementation

DOD should seek legislation that will permit it to implement OMB Circular A-76 as discussed above.

DOD should then proceed to convert or streamline 20 percent of the shortfall noted above during each of the fiscal years 1983 to 1987.

Exhibit II-3ESTIMATED SAVINGS -- CONVERSIONS AND IN-HOUSE STREAMLINING  
(\$ millions)

|                                  | <u>Contract<br/>Conversions</u> |                           | <u>In-house<br/>Streamlining</u> |                           | <u>Total</u>  |                           |
|----------------------------------|---------------------------------|---------------------------|----------------------------------|---------------------------|---------------|---------------------------|
|                                  | <u>Spaces</u>                   | <u>Annual<br/>Savings</u> | <u>Spaces</u>                    | <u>Annual<br/>Savings</u> | <u>Spaces</u> | <u>Annual<br/>Savings</u> |
| FY 79-81                         |                                 |                           |                                  |                           |               |                           |
| a. Actual                        | 11,700                          | \$ 70                     | 700                              | \$14                      | 12,400        | \$ 84                     |
| FY 82-87                         |                                 |                           |                                  |                           |               |                           |
| b. Defense<br>guidance           | 78,438                          | \$706                     | 2,500                            | \$ 60                     | 80,938        | \$766                     |
| c. Expected                      | <u>43,900</u>                   | <u>395</u>                | <u>1,400</u>                     | <u>34</u>                 | <u>45,300</u> | <u>429</u>                |
| d. Shortfall                     | 34,538                          | \$311                     | 1,100                            | \$ 26                     | 35,638        | \$337                     |
| FY 79-87                         |                                 |                           |                                  |                           |               |                           |
| Act. & Def.<br>guidance<br>(a+b) | 90,138                          | \$776                     | 3,200                            | \$ 74                     | 93,338        | \$850                     |
| Expected<br>(a+c)                | <u>55,600</u>                   | <u>465</u>                | <u>2,100</u>                     | <u>48</u>                 | <u>57,700</u> | <u>513</u>                |
| Shortfall                        | 34,538                          | \$311                     | 1,100                            | \$26                      | 35,638        | \$337                     |

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### B. WEAPONS (CONT'D)

#### OSD 15: IMPROVED ORGANIZATION OF THE ACQUISITION FUNCTION

##### Summary Recommendation

The Department of Defense (DOD) should initiate a program to modernize and streamline the total acquisition process. It is our assessment that consolidation of the management of the acquisition process within the Office of the Secretary of Defense (OSD) would improve program efficiency and provide opportunities for significant cost savings. While the OSD Task Force recommends virtually full consolidation of the acquisition process into OSD, interim steps, somewhat short of that goal, are also possible.

##### Financial Impact

Potential Savings: Dollar savings, while considerable, are difficult to quantify and will vary widely depending on the degree of change implemented. In the Savings and Impact Analysis section of this issue, we have estimated some benchmark savings increments possible if recommended changes are implemented to improve the efficiency of the process.

### Background

In the existing system, acquisition policy and guidance are provided by the Office of the Under Secretary of Defense for Research and Engineering. This organization is responsible for basic and applied research, the gathering and exchange of scientific and technical information, establishment of DOD-wide acquisition policies and procedures, oversight of design and engineering functions, and guidance and oversight for the major weapons acquisition process. Each of the services has a similar organization reporting to the Service Secretary, which develops acquisition policies and procedures and oversees the acquisition process -- essentially duplicating the functions performed within OSD.

Each service is structured to provide its own threat evaluation, countermeasure development and engineering design. The acquisition function is performed by large commands reporting to the Service Chiefs who manage the programs and implement the acquisition process. These service commands are:

- DARCOM - Army Materiel and Readiness Command
- NAVMAT - Naval Materiel Command
- AFSC - Air Force Systems Command
- AFLC - Air Force Logistics Command

The current acquisition process is complex and lengthy. Guidelines, policies and procedures on acquisition of major weapons systems are provided to the Services in DOD Directive 5000.1 and DOD Instruction 5000.2. A system is designated as major when Research, Development, Test and Evaluation (RDT&E) funds exceed \$200 million or production funds exceed \$1 billion.

The systems acquisition process is divided into four distinct phases -- concept exploration, demonstration and validation, full-scale development, and production and deployment. These are illustrated in Exhibit II-4 at the end of this issue.

Before the four acquisition stages are initiated, a service must determine that there is a mission need (i.e., potential threat) for which existing capability is deficient. In the case of major systems, the service then prepares a Justification of Major System New Starts (JMSNS), which is a precise articulation of what is required of a new weapons system or what modifications are required in existing systems to meet the stated mission. The JMSNS is submitted to the Secretary of Defense with the service's Program Objectives Memorandum for the budget year in which funds are requested to initiate a new program start.



In Phase 1, concept exploration, the services identify and explore various alternatives to satisfy the mission need. The results are summarized in the System Concept Paper, which contains those concepts that will be carried into the next phase, the reasons for eliminating other concepts, and a description of the acquisition strategy. The Secretary of Defense, through the Defense Systems Acquisition Review Council (DSARC), must provide authority to proceed into the next phase. This point is called Milestone I.

In Phase 2, demonstration and validation, the system is refined through extensive study and further analysis. Some hardware may be developed and tested in order to provide a better definition of performance, cost and producibility. Usually, prototypes are created by several firms in competition for the production contract. This phase provides the input and rationale for deciding which system, if any, should move into full-scale development. The decision, made by DSARC, to move into the next phase is called Milestone II. This is a critical point in the process where the commitment is made to expend major resources.

Phase 3 is full-scale development. The decision to go into full-scale development is supported by information in the Decision Coordinating Paper (DCP) and the Integrated Program Summary (IPS), prepared by the appropriate program office. The DCP identifies the alternatives, goals, thresholds and costs. The IPS, which should not repeat data in the DCP, provides more specific information and a comprehensive summary of the program. It is at this stage that major contracts are negotiated with private industry. Engineering models of the weapon and principal support items are designed, developed, fabricated and tested. Procurement of long lead-time production items and limited production of the system often occur during this phase. Documentation of test results, cost estimates and proposed schedules are presented to DSARC for the Milestone III decision that is needed to put the weapon into production.

Phase 4, production and deployment, is the final phase in the process, when the weapon is produced in volume. It is an ongoing phase that ends when the last system is delivered and accepted, or when the weapon becomes obsolete. Normally, 80 percent of the weapons systems costs are incurred in this phase.

### Methodology

In developing this issue, the Task Force conducted interviews with former DOD officials who served in the capacities of: Secretary of Defense, Deputy Secretary of Defense, Service Secretary, and Chairman of the Joint Chiefs of Staff. We also interviewed incumbent DOD officials, as well as private sector individuals knowledgeable in the area of DOD procurement. We also performed a comprehensive review of numerous pertinent published materials on the subject.

### Findings

As the OSD Task Force analyzed the DOD acquisition process (see Issues OSD 16 through OSD 23), it became apparent that many of the acquisition-related problems are rooted in the department's organizational structure. In this issue, we provide a private sector perspective on possible solutions.

DOD's weapons acquisition system is massive. The proposed total obligational authority for fiscal year 1983 was more than \$70 billion for procurement of aircraft, missiles, ships, combat vehicles, weapons and torpedoes. RDT&E accounted for another \$24.3 billion.

There are 65,000 people in DOD who are directly involved in the acquisition process. In addition, personnel in the various commands support the acquisition function. The number of support personnel is difficult to determine, but our research indicates that as many as 7.5 support personnel are required for each person directly involved, for a total DOD involvement of perhaps 500,000 people. In addition, an estimated 3,000,000 contractor personnel are affected by procurement decisions.

The sheer dollar magnitude of the DOD weapons acquisition program ensures that the acquisition process is carefully scrutinized by private industry, the Congress, the press and the public at large. When a program incurs major cost overruns, DOD is soundly reproached by all of these groups, and the perception is reinforced that the acquisition process is largely inefficient and uncontrollable.

Not only does DOD have to cope with meeting the need for weapons, but it must be recognized that there is also a strong push to sell to DOD. This push comes from vendors who market weapons systems as well as from private and

public sector representatives of the areas where the weapons systems would be manufactured.

As a general rule, each service prefers to have weapons that are unique, even though another service has developed a system for the same broad purpose. Further, as noted in Issue OSD 20, the overuse of military specifications can drive up the cost of weapons systems beyond what is reasonably necessary.

OSD must pass judgment on each proposed weapons system. However, there is a considerable body of evidence to suggest that they are not in as full possession of data and the range of options available as they should be, since they are not as close to program planning as the services are.

Critics of the current weapons acquisition process make the following points:

- o DOD spends enormous amounts of money and time to obtain weapons that are on the leading edge of technology, but too few are available for use.
- o The lead time between conceptualization and development is too long.
- o Inadequate attention is paid to long-term affordability. Therefore, the trade-off between alternative weapons systems is made too late.
- o Whereas DOD personnel costs have somewhat more than doubled since 1974, and operations and maintenance costs have almost tripled, procurement costs are five times the 1974 level.

### Conclusions

We have identified specific problems relating to the acquisition of major systems in the weapons section (Issues OSD 16 through OSD 23). It is difficult to isolate the conditions which contribute to a particular problem, due to the complexity of the acquisition process and the large number of personnel and procedures involved. In this issue we discuss the acquisition process in the context of the DOD organizational structure and the problems that organizational factors contribute to the procurement of major weapons systems.

Organizationally, the major OSD policy functions involved in the acquisition process report to the Under Secretary of Defense for Research and Engineering. There are, of course, some arguments for tying research and engineering with procurement, particularly in the high technology world of defense systems. Probably the reason most often cited is that research and engineering are ongoing processes which continue into the procurement-production phases. While this is undoubtedly true, as the DOD operates today, this organization is one of the principal causes of stretched-out delivery cycles and resultant cost escalation.

The managerial skills employed by a research and engineering executive differ markedly from those needed by a procurement and production executive. It would be difficult for one manager to function effectively in both roles and to maintain the discipline needed at the interface between the two major phases of the acquisition process. A recognized authority, Dr. Jacques S. Gansler, supports this conclusion when he states that "effort must be made toward separating R&D and Production in business areas that would stand on their own. This change would give far more flexibility to the operation and structure of the defense industry."<sup>1/</sup>

In the existing process, major weapons systems are acquired by separate organizations in each of the three services. Each service maintains personnel to perform the same acquisition management and administrative functions in areas such as contract and other reporting requirements, data processing systems, requests for proposals, interface with industry, implementation of procurement regulations and contract administration.

In addition to this massive duplication of effort among the services and between the services and OSD, the current organization discourages optimization of total DOD procurement spending. Procurement funds are distributed by program among the three services, each of which operates independently of the other. Each service speaks for itself and defends its weapons programs against those of the other services when necessary.

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<sup>1/</sup> Gansler, J.S. The Defense Industry. The MIT Press, 1980, p. 265.

Interservice rivalry for procurement funds compounds the problem. It appears that each service is inclined to underestimate proposed weapons systems costs, either to make its system appear more cost-effective than proposed systems of competing services, or to be allowed to start even more weapons. Theoretically, service-neutral advice to the civilian OSD management from the Joint Chiefs of Staff (JCS) should help in the priority setting process. In practice, however, the service affiliations of the JCS and the Joint Staff have created an environment that usually precludes the provision of truly neutral advice.

Once selected, a weapons system develops a constituency within the service and within the Congress and industry. Therefore, it becomes very difficult to terminate a program, even if it experiences cost overruns or exhibits only marginal performance. Historically, neither the cost estimates generated by the services or by the Cost Analysis Improvement Group of the OSD Office of Program, Analysis, and Evaluation have been adequate as predictors of actual experience. Thus, they lend insufficient input into the process whereby the civilian management of DOD tries to establish program priorities in an environment of limited resources.

Cost underestimation in the early stages of the acquisition process generally leads to successive changes in the cost estimates as the program moves through the acquisition phases. This factor, along with continual changes in the quantity procured, in production rates, in engineering designs and in available funding leads to overall program instability. It has been estimated that approximately 20 percent of the actual cost of a weapons system represents costs associated with program instability.

The OSD Task Force suggests that a more centralized focus on the acquisition process at the OSD level would reduce instability in the process. OSD would be able to maintain the objectivity necessary to resist proposed instability changes in high priority programs. OSD's objectivity would allow the elimination of marginal programs from the DOD budget, something the services are generally not able to do because of their vested interest in their own programs.

The OSD Task Force feels that consolidation of the management of the acquisition process at the OSD level would improve the focus and effectiveness of the DOD procurement effort. It would also create an opportunity

for organizational restructuring of the acquisition process to eliminate many of the problems discussed in the OSD Task Force weapons acquisition issues.

Our recommendation for consolidation is not a rejection of decentralization. Indeed, it may very well be beneficial to decentralize along functional, specialty or regional lines. The problem with the existing system is decentralization by service.

Our recommendations for consolidation of the weapons acquisition process will result in an elevation of the importance of the acquisition function as a discrete process within DOD. As part of this process of reorganization, we are impressed by the arguments advanced for reform of the institutions that provide military advice to the civilian leadership of the department. Although our conclusions derive from our findings with respect to problems observed in the acquisition process, it should be noted that many respected military and civilian leaders believe that reform of the JCS and Joint Staff will improve the ability of the department to carry out its mission. (See U.S. Congress, House of Representatives, Reorganization Proposal for the Joint Chiefs of Staff, Hearings Before the Investigations Subcommittee, 97th Congress, 2nd Session, April-August 1982.)

#### Recommendations

OSD 15-1: DOD should consolidate the acquisition function -- separate from the research and engineering activities in the acquisition process -- under a newly created position of Under Secretary of Defense for Acquisition. This new Under Secretary would be responsible for management of the procurement and production phases of the acquisition process.

We believe that separating the procurement and production phases of acquisition from the research and engineering phases would bring much-needed discipline to the acquisition process within DOD. It would require that designs be completed and accepted before major procurement and production began. This could defer some ongoing improvements in technology, but would focus attention on changes and force an analysis of each proposed change on the basis of impact on timing and cost, as well as benefit to the user. Additionally, it would lead to an important focus on fast, economical delivery of systems designed for possible future retrofit with improved items of technology.



Emphasis on cycle reduction and unit cost could also lead to more widespread use of standardized subsystems and the Preplanned Product Improvement Program as a cost-reduction measure.

We suggest four progressively advanced and broad-based alternatives in acquisition procedures which the Secretary of Defense should consider. We recommend that the fourth suggestion, total consolidation of acquisition, be the target organizational structure for the DOD procurement program. We recognize that significant changes in OSD and the services would have to be implemented to reach this target. Implementation of any of the alternatives would constitute a major improvement.

A uniform system of procurement -- at a minimum, we recommend that uniform policies and procedures be established for management decision making on acquisition of major weapons systems. The Defense Acquisition Regulations establish uniform policies for the procurement of supplies and services, but the process of decision making is different in each service. This change would have the major effect of eliminating unnecessary duplication of effort and would provide a uniform system for the military-industrial complex to deal with, regardless of which service is involved.

A commodity approach to procurement -- under this alternative, the acquisition function would continue within each of the services. However, procurement of similar systems would be handled by a single consolidated organization located within the most logical service. For example, in this type of approach, the Air Force would procure all aircraft, regardless of the end use organization. This approach would incorporate the single manager concept in the weapons acquisition process. The single manager approach has been used successfully for procurement of certain consumable items for some years.

Consolidation of procurement and production -- under this alternative, we recommend consolidation of the management of the acquisition phases for procurement through production into a single agency reporting to OSD. The services would retain the functions of mission need analysis, countermeasure conceptualization, research and engineering, test and evaluation, and acceptance. When the service was satisfied that the system met its need, the project would be given to the acquisition organization for contracting and production.

Total consolidation of acquisition -- under this preferred alternative, we recommend the total consolidation of the acquisition function at the OSD level; i.e., research and engineering functions should be consolidated under the Under Secretary of Defense for Research and Engineering; and procurement and production functions should be consolidated under the Under Secretary of Defense for Acquisition (as proposed herein). This would require removing the research and engineering functions from the services. The services would determine mission needs, conceptualize countermeasures, develop mission element needs statements, and charge the acquisition agency with development and production of weapons systems to meet these needs at a minimum cost on an agreed schedule. The services would retain the functions of test and evaluation and acceptance of the final system.

It should be noted that such an approach would be similar to the practices adopted by many of our European allies.

We feel that there are many efficiency and cost reduction benefits to be gained from implementation of the above recommended changes. Perhaps the most significant benefits would be in the area of reduction in program instability and the attendant problems. Consolidation of acquisition functions would encourage implementation of the 32 initiatives in the Acquisition Improvement Program, provide a more objective basis for decisions to accept or reject proposed competing programs from the services, allow DOD to present a single position to Congress and the public on acquisition matters, and facilitate the promulgation of uniform procurement policies and procedures to control the acquisition process.

It is apparent that DOD will be under constantly increasing pressure to provide more defense capability with the same or fewer resources. It is essential, therefore, that DOD structure itself so that equal balance be given to decisions regarding cost and timing of weapons systems programs as well as user needs and the embodiment of the latest technology considerations.

#### Savings and Impact Analysis

The installation of consolidated management of the weapons acquisition process holds the potential of saving many billions, perhaps even tens of billions of dollars annually in the aggregate, from better decision making.

Further, we estimate that each 1 percent reduction in the 500,000 personnel now involved in the acquisition process would save approximately \$150 million. No savings are claimed in this report, however.

#### Implementation

DOD should seek legislation to establish the position of Under Secretary of Defense for Acquisition within OSD. The new Under Secretary should then develop and implement a plan to modernize the total acquisition process in DOD as discussed above.

Exhibit II-4

## WEAPONS ACQUISITION PROCESS

| <u>Acquisition Phase</u>     |         | <u>Milestone Decisions (At End of Phase)</u> | <u>Approximate Time To Complete</u> | <u>Program Costs Expended</u> |
|------------------------------|---------|----------------------------------------------|-------------------------------------|-------------------------------|
| Concept Exploration          | Phase 1 | Milestone I                                  | 4-7 years                           | 20%                           |
| Demonstration and Validation | Phase 2 | Milestone II                                 |                                     |                               |
| Full Scale Development       | Phase 3 | Milestone III                                | 4-6 years                           | 80%                           |
| Production                   | Phase 4 |                                              | 3-5 years                           |                               |

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### B. WEAPONS (CONT'D)

#### OSD 17: REGULATORY CONSTRAINTS

##### Summary Recommendation

The Department of Defense (DOD) should take appropriate action to simplify the complex regulatory system which governs the acquisition of weapons systems. This is essential for improving and expanding the competitiveness of the industrial base.

##### Financial Impact

Potential Savings: While it is difficult to quantify, simplification of the procurement process should reduce direct Government costs and indirect contractor compliance costs that are reimbursed by DOD. To the extent that regulatory simplification will attract additional suppliers, the increased competition should lead to lower contractor bids.

##### Background

The Armed Services Procurement Act is the primary statutory basis for procurement procedures in DOD. This Act sets forth broad policy guidelines for the acquisition of weapons systems, and DOD has issued a myriad of regulations and directives to implement the Act.

The Defense Acquisition Regulations (DAR) comprise the major regulatory document issued by the Office of the Secretary of Defense (OSD), which governs procurement by the services. The stated purpose of DAR is to establish for DOD uniform policies and procedures related to the procurement of supplies and services. The services and the Defense Logistics Agency issue their own procurement regulations to implement DAR. OSD and the services also issue various appendices, supplements, directives, and manuals which influence the procurement of weapons systems.

In these various promulgations, DOD attempts to cover all aspects of the contracting process, such as how to choose among various types of contracts, how to negotiate prices, reporting requirements, how contractors are required to set up their accounting systems and allocate their costs (which allocated contractor costs are reimbursable by the department), etc. In published regulations alone, there are approximately 7,500 pages and a half million words of instruction material that apply to Government and industry personnel in contracting with DOD. Approximately 65,000 DOD employees are involved in direct acquisition activities in addition to more than 500,000 support personnel. Another 3,000,000 contractor personnel are employed by industry, whose costs are paid for in contract prices via contractor overhead or direct contract costs.

#### Methodology

Interviews were conducted with DOD and Office of Federal Procurement Policy (OFPP) personnel involved in the procurement regulations. We also interviewed industry executives responsible for complying with the regulations. We reviewed numerous Government regulations, as well as the process by which the DAR Council develops regulations. Considerable data used by the OFPP in developing the proposed new procurement system were also reviewed.

#### Findings

One of the reasons most often cited for the detailed procedures included in the DAR and the implementing regulations issued by the services is that many Government personnel involved in procurement lack the technical skills to use a high degree of professional judgment in making decisions. Most industry and Government personnel believe that the Government procurement regulations are too rigid. However, most Government personnel strictly adhere to the regulations, even when some flexibility is intended by the regulations, in order to avoid criticism.

The OSD Task Force reviewed the procurement policies of several major companies involved in both defense and non-defense work. These companies procure significant amounts of supplies and services from vendors and subcontractors, and the function of procurement is very important to the overall operation of these companies. Without exception, the companies have developed and issued broad policy-type statements for use by all divisions and

subsidiaries, rather than detailed procedures such as DOD uses. Included in this material, and reinforced in discussions with industry representatives, are frequent references to the need to rely upon professional judgment of procurement personnel, not detailed regulations and procedures.

The OSD Task Force recognizes that Government procurement is on a much larger scale than that of any individual company, and that the high technology products that the Government purchases are generally more advanced than such products purchased by most companies. Another major difference between procurement in Government and industry lies in the concept of public vs. private accountability for funds expended. It is generally required that public funds be more closely accounted for and controlled than private funds. The Government evidently perceives that the promulgation of detailed regulations leads to improved accountability.

However, the OSD Task Force believes that DOD places undue reliance on written regulations to accomplish the job of acquiring weapons systems. Current procedures do not adequately recognize that the procurement of billions of dollars in supplies and services each year is a job for highly skilled professionals, using maximum judgment and minimum reliance on written regulations. Private industry has learned that spending scarce private funds is best accomplished, not by voluminous written regulations, but by brief policy statements which provide guidance for skilled professionals.

Discussions with industry representatives and a review of other data indicate that the high cost of excessive DOD regulations is significant, and it affects a broad range of contractor activity and drives up the cost of Government procurement. OSD itself estimates that contractually imposed management systems and data requirements cost eight cents out of every dollar spent for procurement. In addition, the detailed reporting requirements and the necessary administrative procedures connected with defense contracting have discouraged small and medium-size firms from doing business with the Government, resulting in a substantial decline in the industrial base at the subcontractor level during the last 20 years.

OFPP was charged by the Congress with developing a uniform procurement system for all Government agencies, including DOD. In its report to the Congress in 1982, OFPP recognized significant problems in existing procurement regulations of all agencies. Total savings of the new



procurement system were estimated by OFPP at \$9 billion, with almost \$4 billion related to regulatory simplification and use of a professional work force.

In summary, the OSD Task Force estimates that in its quest for uniformity in procurement matters, DOD has published a half million words on thousands of different contractual issues, attempting to address every possible eventuality in the contracting process. In so doing, it has created a chaotic regulatory environment with the following results:

- o High cost to the Government to maintain DAR and other regulatory matters.
- o High cost to the Government to implement the regulations, including the layering of personnel to respond to regulatory requirements.
- o Overly precise procedures that inhibit the exercise of professional judgment by contracting officers and other Government personnel.
- o High costs to industry--which are passed on to the government via higher contract prices--to comply with the procedures, including unnecessary reporting of data in contract proposals and during the life of the contract.
- o Burdensome regulations which prevent some companies, particularly smaller subcontractors, from selling to the Government, thereby further debilitating our industrial base and lessening competition.
- o Interminable delays in implementing OSD policy-level decisions, due to the slow process within the DAR Council for changing DAR, and the development of multitiered regulations, instructions, etc., at the service level.

#### Recommendations

OSD 17-1: DOD should adopt the following key elements in the OFPP proposal that will improve competition, provide for a less bureaucratic process, and reduce the cost of acquisition of weapons systems:

- o Simplification of the procurement process, which is too cumbersome and costly.

- Improvement in the industrial base by removing excessive regulation and improving competition at the subcontractor level.
- Elimination of profit and fee limitations.
- Development of a highly professional procurement work force so that judgment plays a more important role.
- Elimination of procedural regulations.

The OSD Task Force proposes the following specific actions:

- Where feasible, replace overly detailed procedures specified in the DAR with policy statements to provide general guidance for DOD procurement actions. In developing policy statements, care should be exercised to avoid the sense of rigidity that is presently incorporated into much of the DAR and other instructional material, so as to make greater use of professional judgment by contract administration personnel. The services should not be permitted to issue separate regulations, directives, or instructions that interpret OSD policy statements.
- Develop professional procurement personnel who are technically capable of functioning within broadly stated policy guidelines. Establish training courses for existing and new contract administration personnel to facilitate the transition from working under detailed existing regulations to exercising professional judgment in carrying out OSD policy statements.
- In order to concentrate the regulatory environment on large contracts, limit the mandatory flow down of contractual terms, conditions, and regulations by prime contractors to subcontractors.
- Where there is adequate competition for contracts, increase the use of price analysis techniques in negotiated contract amounts (per ASPR 3-807.2) at both the prime contractor and subcontractor levels as a less expensive alternate to cost analysis.

- o Reexamine contract clauses, forms, and standard contract language with a view to simplification, consolidation, or elimination.

#### Savings and Impact Analysis

While it is difficult to quantify, simplification of the procurement process should reduce direct Government costs and indirect contractor compliance costs that are reimbursed by DOD. To the extent that regulatory simplification will attract additional suppliers, the increased competition should lead to lower contractor and subcontractor bids.

#### Implementation

The Secretary of Defense should simplify existing regulations and procedures governing the acquisition of weapons systems and foster independent professional judgment by contract administration personnel as discussed above.

II. ISSUE AND RECOMMENDATION SUMMARIESB. WEAPONS (CONT'D)OSD 20: COMMON PARTS AND STANDARDSSummary Recommendations

The Department of Defense (DOD) should mandate the use, where possible, by all services of common hardware components, subsystems, equipment, and other parts in order to minimize initial acquisition and life-cycle costs. The use of military standards and specifications should be decreased, and not all components included in the end item being procured should be subject to special military standards and specifications.

Financial Impact

|                        |                                                                                                                                                                                                            |
|------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| \$3.3 billion annually | <u>Potential Savings:</u> Approximately \$2.3 billion from increased use of common parts among all services and \$1.0 billion from decreased application of uniform military standards and specifications. |
| \$0.1 billion annually | <u>Implementation Cost:</u> Annual appropriations of \$100 million for DOD to provide for joint service development of military hardware or software having multiple weapon system applications potential. |

## Background

Different weapons systems frequently include functional elements at the level of components, subsystems, equipment and parts (i.e., computers, radars, tracking devices), which serve the same purpose, but are specially developed and produced for each system. This lack of commonality among essential elements of weapons systems is addressed in Initiative 21 of the Defense Acquisition Improvement Program, which directs DOD to promote the development, specification, and interservice use of common hardware components, subsystems, equipment, and parts in military weapons systems. The objective is for the services to use, wherever possible, elements from other weapons systems that can be modified for a particular use in the new weapon systems at minimum cost.

The term "common parts" has a broad meaning. It includes commercially available aircraft purchased for training purposes as well as something as mundane as commercially distributed machine screws.

Military specifications (MILSPECS) are developed for a wide range of end items being procured, including the various parts, components, and material included in the end items. MILSPECS define the technical characteristics required in the production of such items. Generally, it is more costly to produce an item to a MILSPEC than to a normal commercial standard.

Use of standard, off-the-shelf component equipment, subsystems, and field operational support systems can reduce weapons system development lead time, permitting earlier deployment of more sustainable weapons systems, and lower acquisition and life-cycle costs. Unfortunately, program managers are not generally motivated to focus on this form of cost-saving opportunity.

## Methodology

Senior officials in DOD and industry were interviewed. Extensive articles and issue papers were reviewed, along with various conference reports.

## Findings

The benefits of applying standardization of component parts are of two types: economies of scale obtained by larger volume purchases and economies of scale in maintenance and modification.

The high cost of applying unnecessary military standards and specifications also consists of two parts. One is the cost of verifying, usually in document form, that standards are being accurately applied. Another is the excessive acquisition cost occasioned when a standard specifies qualities not needed in the specific equipment being acquired.

MILSPECS have long been a target of misdirected criticism. The target should be procurement officials who are not sufficiently selective in citing military specifications requirements in contracts. Military specifications are developed for a very wide range of end items being procured. They are referred to as first tier requirements and lower tier requirements which are related to the components and material as well as processes (x-ray, stress tests, welding, tolerances) involved in the manufacture of items used in end item components. It is necessary to develop such a vast array of military specifications because certain of the rigid specifications are in fact needed in acquiring certain end items. The problem has been that if a military specification exists, it will be cited as a requirement in any contract, even though the particular end item procured does not need to meet all such specifications. Procurement officials are not sufficiently selective in choosing only the particular military specifications that are truly needed in relation to the end item being procured.

In connection with the problem, a landmark military-civilian study (1974-1976 Shea Task Force) concluded that the high cost of contractual military specification compliance resulted from failure to utilize the inherent flexibility of the documents in a reasonable and selective way, rather than from a fundamental problem with the specifications themselves. William P. Clements, Deputy Secretary of Defense in 1975, observed, "The initial findings of the (Shea) Task Force have confirmed my concern regarding the need for a coordinated and well managed control over the application of specifications and standards in the end item equipment. This, therefore, is a fertile arena for effective cost reductions in the acquisition process."

### Conclusions

The Office of the Secretary of Defense (OSD) Task Force believes that Government procurement personnel should be more selective and should invoke only those military specifications that relate specifically to the particular needs of the end item being procured. For example, military specification requirements on x-ray of material may be



important in procuring certain items on a space vehicle, but not on all items included in the vehicle, and not on other items being procured for less sensitive use.

In November 1981, OSD sponsored a three-day seminar, "Current Initiatives in the DOD Standardization and Specification Program to Improve the Acquisition Process." Addressing this seminar, Dr. Richard DeLauer, Under Secretary of Defense for Research and Engineering said, "The DOD must find ways to reduce the voluminous RFP (Request for Proposal) responses we require from contractors. We must be willing to take some risks which have a high payoff in terms of cost savings. The challenge is to motivate the acquiring services to specify only that which is essential to a clear understanding of need, rather than dictate contractors' management systems, 'how-to' procedures, or internal methods of accomplishment." DOD's policy statements to accomplish the above are well intentioned, along with organizational emphasis in OSD. However, implementation by the individual services has been slow, in part due to the laborious process of promulgating regulations through the Defense Acquisition Regulations (DAR) Council. In the Council, the individual services must for all practical purposes agree among themselves as to the implementing instructions before such regulations are issued.

The OSD Task Force believes DOD has not adequately addressed the lack of common parts in weapons systems and the excessive use of military specification requirements (rather than normal commercial standards) in contracts. The enormous costs involved require that both OSD and the services change substantially their methods of approaching the problem. OSD must provide incentives for the services to promote commonality and better utilize its existing authority to require standardization. The services must cooperate among themselves toward a common objective of total life-cycle cost reduction among all services. The services must relate to industry in a more cooperative, less adversarial role in order to decrease weapons systems costs.

The long-standing nature of the problems makes them particularly difficult to remedy, since cultural as well as technical issues are involved.

#### Recommendations

OSD 20-1: DOD should link military or commercial hardware standard utilization planning directly to the weapons system cost, performance, reliability and field maintain-

ability objectives for each program. Life-cycle support cost is a particularly important decision variable in acquisition of repairable hardware for combat service.

OSD 20-2: DOD should provide seed money (appropriated funds) as front-end funding to carry out cross-service military hardware design standardization studies as an integral part of the individual weapons systems acquisition process. The objective is to identify the unique system components, subsystems, or equipment that could be adapted to multiple weapons system use without extensive modification.

OSD 20-3: DOD should provide seed money to initiate joint-service development of military hardware (e.g., subsystems, major components, and support systems), or software having multiple weapons system applications potential. Participation of services on equal terms would permit competitive design approaches and second-sourcing of end items.

OSD 20-4: DOD should indemnify the weapons systems contractor when DOD standard equipment used does not measure up to the contractor's overall system requirements.

OSD 20-5: As normal acquisition practice, DOD should consider only MILSPECS related to the item being procured (first tier standards) as required. All other lower tier MILSPECS for material, parts, and components included in the end item should be simply reference documents, and not mandatory, unless individually justified and separately listed in the purchase contract. This is the inverse of present procedure which considers all layers or tiers of cross-referenced documents to be contractual requirements unless formal exception is taken.

OSD 20-6: DOD should authorize the use of financial incentives to encourage contractors to challenge unimportant or irrelevant "standard" requirements when responding to an RFP. These incentives might consist of cash payments or allocating a given number of source selection evaluation points based on the potential cost savings of the proposer's alternative recommendations. (At present, there still is a generally perceived disqualification for "nonresponsiveness" when changes are suggested.)

OSD 20-7: At the Request for Proposal (RFP) stage, DOD should invite all contractors to challenge burdensome data requirements. It should not gather detailed contractor documentation and data merely for proof of performance or "just in case" archives. It should take advantage of contractors' computerized data storage and retrieval systems.

OSD 20-8: After contract award to the lowest qualified competitive bidder, DOD should offer contractual financial incentives for cost savings derived from selective application ("tailoring") of standards. For example, in flexibly priced contracts, such proposals could be incorporated as an instantaneous value engineering proposal without requiring extensive audit or negotiation. (Advanced "tailoring" input for each successive phase of the acquisition process is now DOD policy per Directive 4120.21, November 3, 1980.)

OSD 20-9: At the service level, individuals in charge of standardization efforts should report to the program manager (rather than someone in Logistics Management). The standardization function should be linked to the service laboratory center of technological expertise, so that laboratory consultants can advise when it is timely to identify technology for standardization and also when standardization might impede technology development.

OSD 20-10: DOD should mandate service implementation of OSD standardization policies in DAR without prior approval by the DAR Council. The services should be required to request OSD policy deviations on an exception basis. (This is the inverse of the present system under which individual service administrative and legal representation on the DAR Council can essentially "pocket veto" OSD policy.)

#### Savings and Impact Analysis

We have estimated the potential cost avoidance from applying these suggestions against the \$70.1 billion fiscal year 1983 total obligational authority for weapons acquisition as follows:

##### I. Increased use of common subsystems among services

|                                                                                                                                |               |
|--------------------------------------------------------------------------------------------------------------------------------|---------------|
| o Improved design alternatives for multiple-use and life-cycle cost-effectiveness.                                             | (\$ billions) |
| Estimated 2 percent saving, based on a 1982 Boeing Study.                                                                      | \$1.4020      |
| o Joint service development of multiple use components and subsystems. Estimated 1 percent saving, based on Air Force estimate | 0.7010        |
| o Broader application of existing DOD equipment inventories. Estimated .3 percent saving, based on an OSD Task Force estimate. | <u>0.2103</u> |
| TOTAL                                                                                                                          | \$2.3133      |

## II. Decreased use of military specifications (\$ billions)

|   |                                                                                                                                                                                                      |                        |
|---|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------|
| o | Elimination of requirement for contractors to comply with MILSPECS. Estimated 1 percent saving, based on conservative OSD Task Force estimate.                                                       | \$0.7010               |
| o | Increased use of commercial hardware and equipment, and industry standards rather than MILSPEC requirements. Estimated .5 percent saving, based on research by the Aerospace Industries Association. | <u>\$0.3505</u>        |
|   | <b>TOTAL</b>                                                                                                                                                                                         | <u><b>\$1.0515</b></u> |
|   | <b>TOTAL (I + II)</b>                                                                                                                                                                                | <u><b>\$3.3648</b></u> |

We estimate that it may cost as much as \$100 million annually to provide for joint service development of military hardware or software having potential applicability to multiple weapons systems.

Assuming that savings in the first year would be 33.3 percent and 66.7 percent in the second year before the entire \$3,364.8 million in possible savings is reached, the savings (with a 10 percent inflation factor) would be:

(\$ millions)

|                  | <u>Savings</u>   | <u>Implementation Cost</u> | <u>Total</u>     |
|------------------|------------------|----------------------------|------------------|
| First year       | \$1,120.5        | (\$100.0)                  | \$1,020.5        |
| Second year      | 2,468.8          | (110.0)                    | 2,358.8          |
| Third year       | 4,071.4          | (121.0)                    | 3,950.4          |
| Three-year total | <u>\$7,660.7</u> | <u>(\$331.0)</u>           | <u>\$7,329.7</u> |

### Implementation

The Secretary of Defense should direct the increased use of common components and the decreased use of special military standards and specifications as discussed above. He should also ask Congress to appropriate the funds to provide seed money for joint service projects.

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### B. WEAPONS ISSUES (CONT'D)

#### OSD 22: ESTIMATING WEAPONS SYSTEMS COSTS

##### Summary Recommendation

The Secretary of Defense should establish procedures to ensure more accurate estimates of weapons costs in order to permit better planning and reduce cost overruns. Specifically, provision should be made for establishing a new production cost baseline at Milestone III. The Secretary should also establish procedures to create a policy-oriented data base for use by DOD management. The Department of Defense (DOD) Comptroller should be assigned the responsibility for analyzing the affordability of proposed weapons systems and for monitoring actual costs versus estimated costs. Internal DOD budget data should not be disclosed to contractors at the pre-award stage, because such disclosure encourages contractors to submit bids that are less than their own internal cost estimates. In addition, prior to issuing a Request for Proposal (RFP), DOD should consult with industry in order to give contractors a better understanding of the complexity of the project. Finally, in order to give contractors more incentive to estimate costs more realistically, contracts should be used which require contractors to absorb a greater share of cost overruns.

##### Financial Impact

Potential Savings: Improved cost estimates which, in most cases, would be higher than existing cost estimates would result in the elimination of an estimated 3 to 10 percent of major programs prior to entry into production. Improvement in the estimation of weapons systems costs is a necessary condition for reduction in instability in the weapons acquisition process. We have not attempted to calculate discrete savings attributable to our recommendations regarding each of these two issues. Estimated savings from the reduced instability recommendations (Issue OSD 23) include potential savings attributable to better estimation of weapons systems costs.

### Background

DOD Directive 5000.1 and DOD Instruction 5000.2, recently revised, specify the phases in the major systems acquisition process. The intent of Directive 5000.1 is to delineate prescribed decision points in the acquisition process which require approval of a system, based on such items as technical feasibility, affordability, acquisition time, readiness and system flexibility prior to its moving to the next phase in the acquisition process.

Specifically, decisions are required by the Secretary of Defense for major systems new starts (based on the recommendations of the Defense Resources Board) and based on the recommendations of the Defense Systems Acquisition Review Council (DSARC) at the three so-called milestones. At Milestone I, the concept selection must be approved before the system moves into the demonstration and validation phase. Approval is based on preliminary concepts, cost estimates, schedules, objectives and affordability estimates. At Milestone II, after preliminary data on the system have been defined somewhat in the demonstration and validation phase, the decision is made regarding full-scale development. Milestone III is the production decision point. Approval to proceed into production is contingent upon the appropriate service's demonstration that financial resources are available or can be programmed to complete the system development, to produce efficiently, and to support the deployed system (Exhibit II-4 on page 145 illustrates the process).

DOD Directive 5000.4 provides for independent evaluation of weapons system cost estimates by the OSD Cost Analysis Improvement Group (CAIG). The CAIG provides the DSARC with a review and evaluation of both the independent cost estimates of the services and the program office cost estimates. Independent cost analyses by the services must be prepared by organizations in each service separate from the control and direction of the program office responsible for acquisition of the system.

### Methodology

Interviews were conducted with DOD and industry representatives. Internal DOD data were examined, and various studies, conference reports and articles were reviewed.



### Findings

Despite the various independent estimates and reviews of program cost estimates which are required, DOD has been continually faced with significant cost overruns on weapons systems acquisitions. The Selected Acquisition Report (SAR) of June 30, 1982, indicates that for 39 programs, cost estimating errors alone (exclusive of other elements contributing to cost growth, such as unanticipated inflation or engineering and quantity changes) amounted to \$10.8 billion, or about 9 percent of the original estimated cost of \$124.6 billion.

One reason for cost estimating errors is that the measurement of a program cost overrun compares actual costs to a baseline cost estimate that is prepared early in the life of the development of the weapons system. The baseline cost estimates for major programs reported in the SAR are established at Milestone II, prior to the system's entering the full scale development phase. At this early stage in the development of the weapons system, it is too soon to establish a baseline of estimated program costs against which actual costs will be measured to determine the extent of cost overrun or underrun. Up to Milestone II, only the demonstration of the system and validation of requirements has occurred. Little or no production has occurred, so there is little experience for forecasting costs with any degree of accuracy.

Another part of the problem in cost underestimating lies with contractor underbidding in the initial development phases of the program. The OSD Task Force believes that the problem of intentional underbidding by defense contractors is compounded by defense contractors' underestimation of the actual complexity of producing the system. Based on three major weapons programs, the following revealing information is disclosed by Joseph P. Large in "Bias In Initial Cost Estimates -- How Estimates Can Increase The Cost of Acquiring Weapons Systems":

| <u>Company<br/>internal estimate</u> | <u>Company bid</u> | <u>Final cost</u> |
|--------------------------------------|--------------------|-------------------|
| 1.0                                  | .75                | 2.2               |
| 1.0                                  | .43                | 4.0               |
| 1.0                                  | .45                | 2.0               |

The differential between columns one and three is greater than the difference between columns one and two. This suggests that deliberate understatements of cost are a less important cause of cost growth than failure to appreciate project difficulty.

Poor cost performance in relation to estimates can be tied to both DOD and defense contractors. The use of cost plus fixed fee (CPFF) or cost plus incentive fee (CPIF) contracts during the early stages of weapons systems development has not resulted in sufficient financial incentives to industry to design lower-cost weapons systems. Contractors are given incentives to maximize quality and minimize lead time, rather than to reduce costs. Since there is no commercial type market to establish the value of specific weapons development, many proxy indicators of value -- performance, reliability, development time -- are emphasized, to the detriment of lower production cost.

Also, there is the constant desire to use the latest -- and sometimes very risky -- technology. DOD desires the most sophisticated system and the contractor desires to outwit any possible competition. Often the technology is introduced too late in the development phase, causing program stretchout or, conversely, fitting it into the development cycle -- causing higher production costs related to the need to produce in a timely and reliable manner.

#### Conclusions

The inadequacy of affordability reviews throughout the acquisition process, even though clearly called for in DOD Directive 5000.1, contributes to higher costs in many cases. Although current policy specifies affordability reviews at the various milestones, it is apparent that earlier and more constant attention is needed to the issue of the affordability of each individual system in relation to total systems being procured.

This matter is addressed, in part, in Issue OSD 21, in which we demonstrate the need for better cost estimates and long-term affordability reviews at the point where the decision is made to start a new development program. In this issue, we focus on the need for better cost estimates and affordability reviews in relation to the Milestone III decision to move from development of a program into production.

The OSD Task Force believes that weapons system cost estimates should be made separately for the development and production phases and that baseline costs of production should be more accurately projected. Development is by its nature risky and cost estimates for this phase of acquisition should be more flexible. It is estimated that total RDT&E costs represent only 20 percent of total weapons acquisition cost. At the completion of the RDT&E phase, estimates of baseline production costs and affordability

could be more accurately determined. At this point (Milestone III), approximately 80 percent of estimated program costs are yet to be expended. If it is determined that the system is not affordable at this point, it is better to terminate the program at Milestone III and write off the 20 percent investment, rather than proceed with an unaffordable or inadequate system.

We recognize that some analysts, perhaps including the Congress and its staffs, may resist this suggestion, preferring to "hold their feet to the fire" based upon the development estimates. We believe, however, that a weapons system becomes qualitatively and quantitatively different when it moves from development to production. This is in keeping with our view of the distinct differences between research and engineering and acquisition.

We therefore urge that a new baseline be established for Milestone III in order that management of the production process can more accurately be portrayed and evaluated. It is these data which have the most pertinence for oversight. The Milestone III decision should have been made with full cognizance of historical development and a much clearer look into the future. This is the point from which DOD performance or production should be judged.

The lessons learned through development are valuable and should not be lost. Care should be taken to see that a backward look remains available, when such analysis is pertinent. Such a supplementary record can be easily designed. We do not believe, as we have noted, that it is the most relevant tool for measuring production performance.

CAIG advises DSARC on their assessment of program cost estimates. Generally, CAIG's evaluation indicates that costs will be 20 to 25 percent higher than the program office cost estimates. History has shown the CAIG estimates closer to reality, and yet little use appears to have been made of the CAIG estimates when the DSARC approves a program. The program office estimates are generally used. Recently, however, there have been isolated cases in which CAIG estimates have played a more important role in the decision-making process.

One problem with trying to get at the issue of affordability is the great difficulty OSD decisionmakers have had trying to understand what forces are at work influencing the outcomes in individual programs, in sets of programs involving similar equipment, across services, etc. It has only been since the early 1970s that OSD has had available to it a record-keeping system that tracks the cost progress of individual major weapon system programs both by quarterly

recording of changes in projected cost of the system and by attempting to categorize cost change by different cause. The Selected Acquisition Reports, created for use in the Congressional review process, are an enormous improvement over the data available prior to their creation. Notwithstanding that, however, their current structure could be improved in order to make them a more policy-oriented management tool, as well as a provider of more useful information to the Congress.

For example, cost data are usually presented as base-year (DE year) constant dollars and also as current and future year inflated dollars. This system makes it very difficult (without recomputation) to do comparisons of cost growth across more than one program. Thus, it is difficult to tell how one aircraft program is doing relative to another, etc. Further, the rather significant fluctuations in inflation over the last several years make not having a measure related to the current year's conditions an even more serious omission. Therefore, we recommend that the SARs adopt a reporting format which includes base-year dollars, current year dollars, and then-year dollars. In the case of then-year dollars, we note the importance of using the most up-to-date, realistic estimates of future inflation.

The other area for improvement in the SARs is the categorization of reasons for cost change. In addition to inflation, these include quantity change, schedule change, engineering change, estimating error, support cost variance, cost overrun/underrun and unpredictable and contract performance incentives. Although this is certainly an improvement over simply labeling all change as "underrun or overrun," these categories still tend to report on the effects, rather than the underlying causes of cost growth. And, of course, it is just this information about causes that is so vital to OSD decisionmakers.

The importance of getting at root causes is well illustrated by a 1979 Rand Corporation Study, Acquisition Policy Effectiveness: Department of Defense Experience in the 1970s. According to the Rand Study, which was based on a sample of 31 SAR level programs, the most frequent cause for the schedule slips reported had to do with inadequate annual funding. The reasons for inadequate annual funding varied by program, but they often included Congressional cuts, reassignment to higher priority systems, cost growth due to performance increase, etc. The point is that, without this kind of visibility into just why a particular schedule slips or, occasionally, speeds up, OSD management does not have an adequate management information system from which to arrive at appropriate policy judgments. This

deficiency seems particularly acute in the weapons acquisition environment where the number of players, including some external to DOD, suggests that remedies to some of the problems must come from outside the institution of the Department of Defense.

The Rand analysis concluded that the most important underlying causes of cost growth observed (after effects of inflation and quantity change were factored out) were inadequate funding, unexpected technical difficulties, changes in equipment performance, and estimating errors. The study also recommended that the SARs be revised to incorporate these or similar categories in order to provide information on cost growth and its fundamental causes.

#### Recommendations

OSD 22-1: DOD should assign responsibility for analyzing the affordability of weapons systems to the DOD Comptroller.

Under the existing procedures, no one person is responsible for determining individual system affordability. Assigning the analysis responsibility to the Comptroller would add some independent judgment and control in the weapons acquisition process and provide the Secretary of Defense with a means of tracking and ensuring balance between financial implications and the acquisition process. The Comptroller is independent of program offices in the services and other parts of OSD that play a role in the acquisition process. In addition, the Comptroller's knowledge of financial matters in the entire DOD, including the financial status of other major weapons systems, should provide a sufficiently broad perspective relative to the issue of affordability of individual systems. Also, the Comptroller can perform more effectively if the CAIG function reports directly to the Comptroller.

OSD 22-2: When budgeting the acquisition of a weapons system, DOD should use the higher of the estimates submitted by either the CAIG or the program management office. While neither has been totally accurate in the past, it is believed that the CAIG estimates are closer to reality. The program manager's performance should be judged against his estimate -- assuming program manager continuity through decisive milestones.

OSD 22-3: DOD should establish a new production cost-estimating baseline for measuring program performance once a system is ready for the Milestone III decision to go into production. Milestone II is too early in weapons systems development for establishing the baseline production cost for a system. At Milestone III, most systems are fully developed and tested, and a limited production run has been accomplished, assuring more accurate cost figures. However, in some cases, the baseline should be set subsequent to Milestone III, if accurate cost forecasts are still unavailable at that point.

While the OSD Task Force is of the view that the production decision at Milestone III warrants a new baseline, we recognize that there will be resistance to the recommendation if the weapon configuration generally conforms to the Milestone II assumptions and design. In such cases, it may not be deemed worthwhile to develop a new baseline. However, it is strongly urged that a new baseline be mutually agreed to by DOD and the Congress when significant configuration changes have occurred.

OSD 22-4: To encourage contractors to estimate target costs more realistically in contract negotiations and to decrease costs further during development contracts, DOD should consider using contracts which permit the Government and contractor to share in cost underruns (as at present), but which require the contractor to absorb a greater share of cost overruns, except perhaps for economic price adjustments. Currently, individual contracts are awarded to contractors for the purpose of developing a weapons system that may eventually go into full-scale production under future contracts. Under these development-type contracts, target costs and target profits are negotiated along with sharing ratios (e.g., 30 percent contractor, 70 percent Government) for cost overruns and underruns, in order to give contractors incentives to decrease costs. A particular concern of this recommendation is that a method should be determined that will relieve the Government from sharing in cost overruns that are attributable to deliberate underbidding on the part of the contractor. If contractors are required to absorb a greater share of cost overruns, the target costs included in the contracts should be more accurate. Contract target costs will then provide a more useful basis for assessing the ultimate affordability of weapons systems.

OSD 22-5: DOD should release RFP for new weapons systems to industry without revealing DOD budget figures. Currently, when DOD releases an RFP, contractors acquire DOD acquisition strategy and budget figures. It is common knowledge that contractors have, in many cases, underbid



their own internal estimates so as not to exceed DOD budget amounts. Frequently, cost-type contracts are used at this early stage of the acquisition cycle so that the ultimate effect is a cost overrun which is absorbed primarily or entirely by the Government.

OSD 22-6: Prior to issuance of an RFP, DOD should informally consult with potential contractors in order to aid in contractor understanding of the project and to allow contractor input. Studies have indicated that some cost underestimation results when contractors do not fully understand the scope and complexity of the program.

OSD 22-7: DOD should propose revision of the SAR reporting format in order to make these reports a more useful management information tool.

#### Savings and Impact Analysis

Better estimates of weapons systems costs is one of the factors necessary to reduce instability in the weapons acquisition process. We project that improvements in weapons cost estimates would ultimately reduce by 3 to 10 percent the number of major programs which enter full scale production.

We have estimated that approximately \$5.2575 billion in annual savings (in then-year dollars) could accrue from an overall reduction in instability in the acquisition process (see Issue OSD 23). This estimate includes the savings which would result from improvements in estimating weapons costs, which in itself would lead to reduced instability costs.

#### Implementation

The Secretary of Defense should direct that procedures for estimating weapons systems costs be revised as discussed above. In addition, contractors should be better informed about the complexity of programs at the bidding stage. Finally, greater incentives should be built into contracts to preclude deliberate underbidding and to discourage cost overruns.

## II. ISSUE AND RECOMMENDATION SUMMARIES (CONT'D)

### B. WEAPONS ISSUES (CONT'D)

#### OSD 23: INSTABILITY IN THE WEAPONS ACQUISITION PROCESS

##### Summary Recommendation

The Department of Defense (DOD) should commit to a stable five-year spending plan for the acquisition of weapons systems at economical production rates. DOD should focus the attention of Congress on any significant increase in costs that would result from proposals to change the plan. Critical to achieving such a plan for program stability is the DOD's ability to relate financial affordability to proposed new systems early in the budgetary cycle. This would avoid accumulating systems that cannot be funded in economic production quantities during the entire production cycle.

##### Financial Impact

|                                                                                    |                                                                                                                                                                                                                                                                                                                                                                                                                                              |
|------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>\$5.2575<br/>billion<br/>annually<br/>(after full<br/>implementa-<br/>tion)</p> | <p><u>Potential Savings:</u> Cost growth due to instability on 25 major programs studied recently is estimated to be \$27 billion per year. While it is not possible to control instability completely, the improvements recommended herein should save at least 5 to 10 percent of the annual weapons costs (approximately \$70 billion) or approximately \$5.2575 billion (in then-year dollars) once full implementation is in place.</p> |
|------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

### Background

For purposes of this report, program instability is defined as any event, except inflation, which causes actual program costs to exceed original estimated costs. Program instability would, therefore, include poor initial cost estimates, stretched and delayed production schedules, engineering changes, quantity changes and poor contractor performance.

Issue OSD 21 estimates savings available in RDT&E phases through limiting new starts. Issue OSD 22 discusses the problems associated with poor cost estimation, particularly at the time of the Milestone III decision to go into full-scale production. This issue treats the excess costs incurred in the production phase due to instability. Because inadequate cost estimates contribute to instability, the savings attributable to both issues OSD 22 and OSD 23 are combined.

### Methodology

The Task Force conducted over 100 interviews with personnel in OSD, the services, and private industry. It also reviewed various articles, conference reports, books, many internal DOD reports and reports of the General Accounting Office (GAO).

The concerns addressed by this issue and OSD 22 were also addressed by the President's Private Sector Survey Procurement/Contracts/Inventory Management Task Force in their issues PROC 4 (Multi-year Contracting), PROC 6 (Planning), and PROC 8 (Cost Estimating and Scheduling). That task force estimated that \$8.8 billion could be saved in DOD weapons procurement in the first three years through the adoption of their recommendations.

### Findings and Conclusions

The OSD Task Force traced the program cost estimates for 25 major weapons systems, based upon an analysis initiated by the Defense Systems Management College. That analysis reviewed the cost growth factors in the acquisition process of major weapons systems.

The 25 major programs that we reviewed were initiated between 1971 and 1978. They have been affected by program changes, technological changes, quantity changes, timing changes and unanticipated inflation. We attempted to

measure the cost growth in these programs through the end of 1981, recognizing that a significant factor in seeming "cost growth" could be due to low cost estimations performed at the onset (see Issue OSD 22).

The 25 programs had an average age of seven years as of year-end 1981, but the weighted average was somewhat less when the size of programs was considered.

We found that the year-end 1981 total of the cost estimates for these 25 programs was 323 percent of the total development estimates made at the time the respective programs were initiated. Our analysis of the cause of cost escalation revealed the following:

|                                                              | (\$ billions) |
|--------------------------------------------------------------|---------------|
| Total development estimates                                  | \$104.8       |
| Inflation costs beyond assumption<br>in development estimate | 42.3          |
| Program changes made after<br>development estimate           | 129.4         |
| Other changes made after<br>development estimate             | <u>62.7</u>   |
| Total estimated program costs<br>over program life cycle     | \$339.2       |

Even when unanticipated inflation was removed, the cost growth due to instability factors for these 25 programs was \$192.1 billion, or 183 percent of the original development estimate. The total annual increase in program costs, adjusted for year of entry for each program, was \$26.9 billion, or 28.8 percent by weighted average (see Exhibit II-8 at the end of this issue).

This does not imply that the program measured at year-end 1981 was the identical program on which the development estimate was based. It may be, to the extent that the original estimate was unduly low, but other changes must be analyzed as well. These results do demonstrate that affordability cannot be adequately anticipated in the face of such unreliable data. It also demonstrates the high cost of not freezing the design or proceeding to approve the program before the true costs of technological improvements to the design are known.

On the basis of our review of this data, other studies reviewed, and discussions with DOD personnel, the OSD Task Force concluded that DOD has difficulty relating financial affordability to the production of proposed new systems sufficiently early in the decision-making process. As a

result, more systems are put into production than can be funded in economical production quantities during the product cycle of each system, resulting in cost growth for reasons such as stretched production schedules and quantity changes. In this connection, the Selected Acquisition Report (SAR) of June 30, 1981, shows that 40 of 47 programs have experienced changes in the number of units to be procured, and 41 have experienced schedule changes.

On average, the production phase of a weapons system spans about five years and represents 80 percent of the total weapons system cost. The remaining 20 percent of the weapons system cost is represented by prior RDT&E expenditures, including full-scale development, which may have required up to 10 or 15 years before the system was ready for production (Exhibit II-4 on page 145 illustrates the process).

Because most of the funds are spent for procurement, and not development, a careful determination of whether a program will proceed into production or be cancelled should be made at Milestone III. At this point, the determination should be made regarding:

- o whether the particular weapons systems is still required to meet the threat as perceived early on in the R&D work program;
- o whether the weapons system reflects successful and effective culmination of the preceding R&D work;
- o whether the R&D development should be cancelled and written off as an unsuccessful venture;
- o whether the cost of the weapons system in economical production quantities over the entire life cycle is affordable, in relation to other systems presently in production or being considered by DOD.

At the present time, we do not believe that the processes of weapons system selection, internal DOD budgeting for production, and Congressional appropriations are sufficiently interrelated so that an orderly and economical process of weapons system acquisition management may operate. Weapons systems should be acquired at the lowest reasonable cost per unit, which frequently means higher annual rates of production. However, there appear to be many systems in production at uneconomically low production rates that cannot be terminated because of the pressures of various constituencies such as the services, contractors,

and the Congress. We believe the present situation also exists, in part, because of DOD's failure to adequately limit the number of new systems that are initiated (see Issue OSD 21).

Acquiring systems at the lowest reasonable unit cost by insisting on adequate economic production quantities is not presently a high priority in DOD decision-making processes. DOD seems to opt for having large numbers of different systems in production at low, uneconomical rates of production. This is so in spite of the DOD Acquisition Management Improvement Program which states: "We must improve long-range planning to enhance acquisition program stability.... [We must] increase program stability by fully funding R&D and procurement at levels sufficient to ensure efficient cost, supportability and schedule performance, and minimize changes to the approved program."

Multiyear procurement (MYP) is a contractual procedure whereby DOD agrees to purchase from a contractor a stated number of weapons systems each year for several years, usually at a fixed price, but possibly with escalation of certain basic costs based on inflation indices. Only a few weapons systems are presently being procured on MYP contracts. In contrast, most weapons systems are presently procured on the basis of annual contracts, wherein the quantities purchased have a direct relationship to the amount of annual appropriations from Congress. Under this annual basis of procurement, the quantities of any particular system that are purchased can vary significantly from year to year, depending on a wide range of factors, such as overall budget constraints, competing systems, technology changes and the strength of the constituencies in support of the individual system.

Under MYP, the Government and the contractor enter into a long-range financial relationship, at a fixed cost to the Government. In these circumstances, the Government is in a stronger position to negotiate a lower contract price because higher and more stable quantities are procured each year, rather than the lower uneconomical production rates often used under the annual contract procedure.

The OSD Task Force believes MYP is a vehicle for accomplishing program stability and minimizing attendant cost growth. Cost savings from the use of MYP have been estimated at 10 to 20 percent by the Deputy Secretary of Defense. The Navy claims 6 to 35 percent savings over single year procurement on four sample programs. The Air Force claims it could "routinely" save from 10 to 30 percent of total acquisition cost by MYP.



Based on OSD Task Force experience and knowledge of the industry, we believe entering into MYP contractual commitments for many proven systems that enter the production phase would help provide the discipline of program stability on the part of the Administration, Congress, and DOD. We believe all decision makers would take a harder look at the initial decision to procure a particular system under MYP, covering three to five years' production at higher economical annual quantities because of the significant dollars involved, as opposed to the smaller dollars involved in the annual appropriations process. We also believe MYP would force a higher degree of competition among different systems competing for scarce financial resources, with the healthy result that some programs would not be funded for production. Other major benefits of MYP are reduced program costs and an acute awareness of the high cost of program changes such as quantity changes, stretched production and engineering technology changes, all of which contribute to cost growth.

Savings due to MYP can be achieved through any or all of the following:

- o Increased competition at the prime contractor and subcontractor levels.
- o Economic quantity buys of material throughout the subcontractor and supplier base.
- o Improved labor and overhead efficiencies at the prime contractor and subcontractor levels by optimizing costs for start-up and learning.
- o Improved productivity in the manufacturing process as the result of increased corporate capital investments.
- o Reduction of lead times for manufacturing materials and parts in the subcontractor/supplier base. This can occur by permitting the prime contractor to enter the subcontractor/supplier production queues only once at the beginning of the program, instead of having to reenter the queues each year.
- o Improved surge production capability for the overall weapon system, as well as for logistics sustainability, because of the increase of materials ordered at the beginning of the MYP contract.

If MYP were used on a more regular basis, an environment of stability would be achieved within which the acquisition process could function. For example, only a single contract is negotiated under MYP, as opposed to several under the annual appropriations basis. Thus less time is used on administrative functions, such as budget preparation, furnishing and evaluating estimated prices, and changing quantities that influence price estimating.

The higher degree of competition at both the prime contractor and subcontractor levels for the larger contracts resulting from MYP would permit industry to use management techniques, equipment and tooling which would result in providing weapons systems at a lower cost per unit. The MYP contractual arrangement would allow the contractor to commit corporate financial resources, people, facilities, equipment and subcontractors for longer periods of time. This would result in improving the industrial base and making the Government a more attractive customer, thereby increasing competition.

In the experience of the OSD Task Force, increased competition leads not only to lower costs but also to higher improved quality. An illustration of the importance of establishing improved quality is found in the aerospace industry, according to Aviation Week and Space Technology, August 2, 1982. An article by W.H. Gregory indicated that U.S. aerospace managers were averaging only about 12 good assemblies out of every 100. MYP is an excellent tool by which the Government can require the manufacturer, because of the size and stability of the contract, to commit resources to optimize system performance.

As was pointed out in Issue OSD 22, the OSD Task Force believes cost estimates for weapons systems are made too early -- so early that accurate forecasts are nearly impossible. The level of confidence that a major program will be completed within its initial cost estimate (presently made in conjunction with the Milestone II decision to proceed with full-scale development) is only 9 percent (N. Augustine, Concepts, February 1982). Accordingly, baseline production cost estimates, against which actual costs will be compared in many cases should not be made until the project has advanced to Milestone III, when reasonable estimates can be made.

Top management in OSD and program managers for major weapons systems serve in their respective capacities an average of only 30 months. The average life cycle of a weapons system, including R&D and production, is over 13 years. We have determined from private sector sources that industry keeps key employees in positions an average of

eight years for projects and operations of less financial magnitude and technical complexity than major defense weapons systems.

Program managers are not presently held responsible for all aspects of the program, since they are not able to control certain aspects, such as funding and program changes. Accountability for a program is shared by a number of entities -- the services, the program manager, the Congress and OSD. As a result, no one is really held accountable.

#### Recommendations

OSD 23-1: Recognizing that Congress, the Administration, DOD, and contractors have all contributed to past program instability, we believe that in the future, OSD should exercise its authority and play a more aggressive role in controlling defense expenditures. OSD should exercise control in the following ways:

- o For its own and external use, such as Congressional relationships, DOD should make firm five-year spending plans based on economical rates of production. DOD should calculate and focus attention on the cost of changing from those plans prior to any decision to alter the five-year plan by the Congress, any entity in DOD, or the Administration.
- o DOD can minimize cost growth in systems acquisition through commitment to program stability that is best evidenced by MYP contracts.
- o DOD should address both the financial affordability of proposed systems and the defense need for the systems in the annual Defense Guidance Report. At present, this report does not address in sufficient detail the issue of financial affordability. To interlock affordability and need would help prevent starting new systems that cannot be funded in economical production quantities during the entire production cycle.
- o DOD should reestablish its baseline production cost estimate at Milestone III, when program costs can be estimated more realistically.

OSD 23-2: Recognizing that program managers play a key role in the acquisition process, improvement in program stability can also be achieved by DOD action to:

- o Lengthen the assignment period of key Government personnel, such as program managers.
- o Develop a stated career path for program managers to provide incentives for improved performance.
- o Hold program managers accountable for those aspects of the program that they are able to control, recognizing that Congress, OSD, or the services sometimes take control out of their hands.

#### Savings and Impact Analysis

Our sampling of weapons cost escalation indicates that too many weapons systems are allowed to proceed through the acquisition cycle because the potential costs are underestimated at the outset and the costs of changes are not adequately anticipated.

Proper estimating, freezing of the design at a reasonable point, MYP, and curtailing the number of systems produced would enable DOD to purchase the best range of systems that are affordable.

While we recognize that all instability cannot be eliminated, it is our judgment that the implementation of the recommendations for Issue OSD 22 and this issue should be able to reduce instability by as much as 20 percent. We estimate that such stability improvement would yield a 5 to 10 percent savings for weapons production procurement costs, which are currently \$70.1 billion. Mean estimated savings of 7.5 percent would be \$5.2575 billion.

Assuming a ten percent inflation factor and a five-year phase-in to implement the recommendations, the savings would be:

(\$ millions)

|                  |                  |
|------------------|------------------|
| First year       | \$1,051.5        |
| Second year      | 2,313.3          |
| Third year       | 3,816.9          |
| Three-year total | <u>\$7,181.7</u> |
| Fourth year      | \$5,598.2        |
| Fifth year       | \$7,697.5        |

#### Implementation Steps

DOD should seek legislation to permit the increased use of multiyear contracts and the Secretary of Defense should implement the recommendations discussed above to improve stability in the weapons acquisition process.

## Exhibit II-8

INSTABILITY COSTS FOR 25 SELECTED PROGRAMS  
AS OF DECEMBER 1981  
(\$ millions)

| No.     | Program       |              | Orig.<br>cost<br>est. | Cost escalation |                  | Instability<br>cost increase<br>per year |       |
|---------|---------------|--------------|-----------------------|-----------------|------------------|------------------------------------------|-------|
|         | Start<br>date | Age<br>(yrs) |                       | Unanticipated   |                  | \$                                       | %     |
|         |               |              |                       | Inflation       | Instability      |                                          |       |
| 1       | 1977          | 4            | \$4,184               | \$810           | \$3,078          | \$770                                    | 18.4  |
| 2       | 1971          | 10           | 329                   | 125             | 1,122            | 112                                      | 34.1  |
| 3       | 1978          | 3            | 3,186                 | 205             | 743              | 248                                      | 7.8   |
| 4       | 1975          | 6            | 1,563                 | 660             | 932              | 155                                      | 9.9   |
| 5       | 1978          | 3            | 14,084                | 2,400           | 11,099           | 3,700                                    | 26.3  |
| 6       | 1978          | 3            | 1,358                 | 205             | 1,023            | 341                                      | 25.1  |
| 7       | 1972          | 9            | 3,758                 | 1,200           | 2,423            | 269                                      | 7.2   |
| 8       | 1972          | 9            | 5,241                 | 2,075           | 3,393            | 377                                      | 7.2   |
| 9       | 1972          | 9            | 4,779                 | 2,015           | 12,780           | 1,420                                    | 29.7  |
| 10      | 1969          | 12           | 6,166                 | 999             | 28,667           | 2,389                                    | 38.7  |
| 11      | 1970          | 11           | 1,032                 | 325             | 2,153            | 196                                      | 19.0  |
| 12      | 1973          | 8            | 3,245                 | 3,000           | 8,001            | 1,000                                    | 30.8  |
| 13      | 1977          | 4            | 464                   | 545             | 3,221            | 805                                      | 173.5 |
| 14      | 1971          | 10           | 5,748                 | 2,410           | 16,108           | 1,611                                    | 28.0  |
| 15      | 1974          | 7            | 12,431                | 5,940           | 10,127           | 1,447                                    | 11.6  |
| 16      | 1970          | 11           | 2,662                 | 460             | 3,091            | 281                                      | 10.6  |
| 17      | 1970          | 11           | 7,355                 | 3,750           | 29,449           | 2,677                                    | 36.4  |
| 18      | 1975          | 6            | 6,055                 | 3,100           | 31,749           | 5,292                                    | 87.4  |
| 19      | 1973          | 8            | 632                   | 105             | 721              | 90                                       | 14.3  |
| 20      | 1975          | 6            | 12,875                | 10,250          | 16,600           | 2,767                                    | 21.5  |
| 21      | 1975          | 6            | 735                   | 210             | 1,103            | 184                                      | 25.0  |
| 22      | 1970          | 11           | 3,908                 | 810             | 2,039            | 185                                      | 4.7   |
| 23      | 1976          | 5            | 601                   | 220             | 303              | 61                                       | 10.1  |
| 24      | 1977          | 4            | 894                   | 150             | 675              | 169                                      | 18.9  |
| 25      | 1977          | 4            | 1,527                 | 280             | 1,500            | 375                                      | 24.6  |
| TOTAL   |               |              | <u>\$104,812</u>      | <u>\$42,249</u> | <u>\$192,100</u> | <u>26,921</u>                            |       |
| AVERAGE |               |              |                       |                 |                  |                                          | 28.8  |

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 DAVID FRYER, ARIZ.

## United States Senate

COMMITTEE ON  
 GOVERNMENTAL AFFAIRS  
 SUBCOMMITTEE ON  
 OVERSIGHT OF GOVERNMENT MANAGEMENT  
 WASHINGTON, D.C. 20510

SUBCOMMITTEE  
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 SUSAN M. COLLINS, STAFF DIRECTOR

February 21, 1985

Mr. J.P. Bolduc  
 Chief Operating Officer  
 Foundation for the President's Private  
 Sector Survey on Cost Control  
 1511 K Street, N.W.  
 Washington, D.C. 20005

Dear Mr. Bolduc:

Your testimony before the Oversight Subcommittee was extremely helpful in our evaluation of the Grace Commission's recommendations for procurement reform. To follow up on our January 23 hearing, we ask that you respond to these additional questions for the record.

1. As we discussed at the hearing, a joint report by the General Accounting Office and the Congressional Budget Office found the Grace Commission's projected cost savings for recommendations over \$1 billion to be overstated. You pointed out that the Commission has prepared a rebuttal to this report, which we ask you to provide to the Subcommittee.
2. The GAO-CBO report criticized the Grace Commission's assumption of a ten per cent inflation rate which, as you know, is more than double the rate we're experiencing now. You stated at the hearing, however, that even if the assumed inflation rate were reduced by half to five per cent, this would only result in a \$10 billion reduction in the Commission's three-year projected savings from \$424 billion to \$414 billion. Would you explain why such a significant reduction in the assumed inflation rate, which underlies each of your cost-savings estimates, would have such a relatively minimal impact on your overall projected savings?
3. The Commission's three-year projected savings of \$424 billion represents the net savings after double counting is eliminated. According to your testimony, the total savings' figure -- including areas of overlap -- was \$535 billion. Would you provide for the record a listing of the Commission's projected savings and the areas of overlap, focusing primarily on the procurement recommendations?



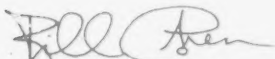
4. You stated that, of the 2,478 recommendations made by the Grace Commission, 73 per cent of the projected savings require congressional action, with the remaining 27 per cent requiring administrative action. Mr. Gish indicated, however, that when considering the action needed to produce the savings, a substantially higher percentage of the recommendations would be under administrative control -- "probably a complete reverse" of the aforementioned percentages, according to your testimony. Would you provide the exact percentages for the record?
5. The Grace Commission recommends that the Office of Federal Procurement Policy should continue to play a strong, central leadership role in procurement reform. While the Commission also recommends that the Office should be integrated more thoroughly into the Office of Management and Budget's management and budget processes, you testified against the Administration's proposal to merge OFPP into the management side of OMB.
  - A. Do you believe that policy integration can be achieved without organizational integration?
  - B. You indicated in your testimony that the OFPP lacks the authority to operate effectively. What additional authority would you recommend be given to OFPP?
6. The Grace Commission recommends that acquisition of "common use" items, such as office equipment and supplies, should be centralized in the General Services Administration. The problem, as was discussed during the hearing, is that agencies frequently ignore GSA and buy their common-use items "off schedule." Joseph Wright agreed that agencies should be required to buy through GSA, when designated as the required source of supply, unless they have a compelling reason for not doing so.
  - A. Are existing regulations adequate to establish GSA as a mandatory source of supply, and do they provide adequate controls for determining whether compelling reasons to buy "off schedule" exist?
  - B. What do you believe OMB should do to ensure that agencies are making maximum use of GSA?
  - C. Is additional legislation necessary to clarify and/or augment GSA's authority with respect to procurement and supply management?

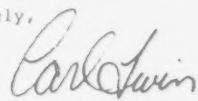
7. The Grace Commission found that many of the defense acquisition-related problems are rooted in the Defense Department's organizational structure. According to the Commission's Task Force report on the Office of the Secretary of Defense, there is a massive duplication of effort among the services, which could be remedied through consolidation of the acquisition management function.
  - A. How do you respond to Mary Ann Gilleece's criticism that "it is false economy to attempt to 'reorganize' your way out of problems?"
  - B. The Grace Commission's estimates of potential savings that would result from the consolidation of acquisition management within the Defense Department are unclear. According to the OSD Task Force report, the Commission claims no savings, but states that consolidated management could potentially save "many billions, perhaps even tens of billions of dollars annually...from better decision making." You testified that the potential savings through implementation of this recommendation would be \$1.4 billion over three years. What is the Commission's estimate for potential savings to be achieved through this recommendation?
  - C. Ms. Gilleece testified that the Grace Commission ignored what the Defense Department believes would be very substantial implementation costs in terms of disruption of operations and displacement of people. Do you agree that there would be substantial implementation costs and, if so, did the Commission take these costs into consideration when recommending that acquisition management should be consolidated within the Defense Department?
8. Cost growth in major weapons systems is largely attributed to inaccurate cost estimates. Many experts believe that independent cost estimates will help curb cost growth, since these estimates have historically been more accurate than the program office estimates. As we discussed at the hearing, however, there appears to be some dispute between the Grace Commission's task force reports as to the utility of independent cost estimating. The OSD task force found independent cost estimates to be valuable, while the Procurement task force (which, contrary to your statement at the hearing, also dealt with weapons acquisition) did not.

- A. Given the OSD task force's findings, how do you explain the findings of the Procurement task force that the existence of independent cost groups in OSD and the services tends to diffuse the estimating effort and contributes to a lack of "ownership" of, and ultimate accountability for, the program estimates?
  - B. The Procurement task force also stated that, in the private sector, the benefits of multiple reviews are not commensurate with the additional effort required. Do you agree?
  - C. The Procurement task force found that part of the cost-estimating problem is that the background of personnel assigned to estimating is too heavily weighted toward business and accounting skills, while not enough emphasis is placed on technical qualifications. Do you agree that this is a problem and, if so, would assigning the cost-estimating responsibility to the Defense Department Comptroller, which the OSD task force recommends, exacerbate the problem?
  - D. Could you provide a detailed analysis of how the Grace Commission arrived at the projected three-year cost savings of \$18.3 billion through improved cost estimates, scheduling, and risk management techniques?
9. In a recent article in The Public Interest, Professor Steven Kelman examined several allegations of waste by the Grace Commission and found serious logical and factual flaws in the Commission's analysis. These allegations examined by Professor Kelman were included in Commission materials entitled "Ten Random Examples of Bureaucratic Absurdity." How do you respond to Professor Kelman's article and the implication of his findings on the Commission's cost estimates?

Finally, we ask that you provide any additional information pertaining to the Grace Commission's recommendations for procurement reform that you would like us to consider. Again, we appreciate your assistance in this endeavor, and we ask for your reply to our questions by March 7, 1985.

Sincerely,

  
William S. Cohen  
Chairman

  
Carl Levin  
Ranking Minority Member



FOUNDATION FOR  
THE PRESIDENT'S PRIVATE SECTOR SURVEY ON COST CONTROL, INC.

March 4, 1985

The Honorable William S. Cohen  
Chairman  
Committee on Governmental Affairs  
Subcommittee on Oversight of  
Government Affairs  
Washington, D.C. 20510

Dear Senator Cohen:

The attached is in response to your letter of February 21st which raised nine questions in reference to my January 23rd testimony before the Subcommittee on Oversight of Government Affairs.

I appreciated the opportunity to testify before the Subcommittee regarding procurement reform, and I hope you will be successful in correcting the deficiencies of the current system.

Implementing the recommendations of the President's Private Sector Survey on Cost Control (PPSS) in this area can save taxpayers billions of dollars annually. Greater efficiency and effectiveness in procurement is an issue that can be supported by everyone -- Democrats and Republicans, liberals and conservatives alike.

Again, thank you for the opportunity of presenting our findings and recommendations.

Sincerely,

J. P. Bolduc

## Question #1:

"As we discussed at the hearing, a joint report by the General Accounting Office and the Congressional Budget Office found the Grace Commission's projected cost savings for recommendations over \$1 billion to be overstated. You pointed out that the Commission has prepared a rebuttal to this report, which we ask you to provide to the Subcommittee."

Our rebuttal to the CPC-GAO analysis is included as Attachment 1.

## Question #2:

"The GAO-CBO report criticized the Grace Commission's assumption of a ten per cent inflation rate which, as you know, is more than double the rate we're experiencing now. You stated at the hearing, however, that even if the assumed inflation rate were reduced by half to five per cent, this would only result in a \$10 billion reduction in the Commission's three-year projected savings from \$424 billion to \$414 billion. Would you explain why such a significant reduction in the assumed inflation rate, which underlies each of your cost-savings estimates, would have such a relatively minimal impact on your overall projected savings?"

The difference in using a 10% inflation rate versus a 5% rate to estimate total PPSS savings is \$20.6 billion over three years -- more than we recalled at the hearing -- but still an insignificant 4.9% difference. Even assuming no inflation, three-year PPSS savings would be \$384.6 billion, or 9.4% less than with 10% annual inflation.

The reason such significant reductions in projected inflation have a relatively minor impact on estimated savings is that the time period over which we are concerned is short. The difference can be expressed roughly as follows:

(Table on following page)



|                             | (1)                              | (2)              | (3)    | (4)         | (5)   | (6)                       |
|-----------------------------|----------------------------------|------------------|--------|-------------|-------|---------------------------|
| Annual<br>Inflation<br>Rate | Constant \$<br>Annual<br>Savings | Inflation Factor |        |             |       | Three-<br>Year<br>Savings |
|                             |                                  | Year 1           | Year 2 | Year 3      | Total |                           |
|                             |                                  | $(1 + r)$        |        | $(1 + r^2)$ |       |                           |
| (1) 0%                      | \$128.2                          | 1.00             | 1.00   | 1.00        | 3.00  | \$384.6                   |
| (2) 5%                      | 128.2                            | 1.00             | 1.05   | 1.10        | 3.15  | 403.8                     |
| (3) 10%                     | 128.2                            | 1.00             | 1.10   | 1.21        | 3.31  | 424.4                     |

---

A difference of  
\$20.6 billion, or  
4.9% less, assuming  
5% inflation rather  
than 10% inflation.

---

As shown, the inflation rate was not a significant factor in determining our total estimated savings.

## Question #3:

"The Commission's three-year projected savings of \$424 billion represents the net savings after double counting is eliminated. According to your testimony, the total savings' figure -- including areas of overlap -- was \$535 billion. Would you provide for the record a listing of the Commission's projected savings and the areas of overlap, focusing primarily on the procurement recommendations?"

Relevant material to question #3 is attached separately as Attachment 2.

## Question #4:

"You stated that, of the 2,478 recommendations made by the Grace Commission, 73 per cent of the projected savings require congressional action, with the remaining 27 per cent requiring administrative action. Mr. Gish indicated, however, that when considering the action needed to produce the savings, a substantially higher percentage of the recommendations would be under administrative control -- "probably a complete reverse" of the aforementioned percentages, according to your testimony. Would you provide the exact percentages for the record?"

Looking only at the recommendations, we estimate 70.8%, or 1,754 recommendations, could be implemented without action from Congress. However, the relatively few recommendations (29.2%) requiring Congressional approval will result in the most significant reductions in Federal spending and the deficit -- e.g., those on Federal retirement systems and Federal health care programs.

However, even straightforward operating decisions, which should be under Administration control, have been and will be significantly influenced by Congressional action. For example, the President's 1986 Budget includes 269 PPSS recommendations. 132 of those recommendations (49.1%) require "substantive legislation." The balance (137 recommendations, or 50.9%) are characterized as requiring "Congressional support." More specifically, the Administration is in the process of reorganizing regional and field offices of the

Social Security Administration, Veterans Administration, and the Departments of Labor, Health and Human Services, and Housing and Urban Development. Representative Norman Dicks noted (Congressional Record, January 31, 1985) that he had "heard from regional agency personnel ... who have revealed the plans for dismantling their agencies."

Mr. Dicks, with the support of Representative Patricia Schroeder, has introduced a bill (H.R. 872) which would prevent changes in the Federal regional office structure, and Mr. Dicks has said that he intends to insert language in appropriations bills prohibiting the use of any Federal funds to implement a reorganization plan. Virtually all of our 2,478 recommendations will involve Congress -- either Congressional action or inaction -- if they are to be implemented.

## Question #5

"The Grace Commission recommends that the Office of Federal Procurement Policy should continue to play a strong, central leadership role in procurement reform. While the Commission also recommends that the Office should be integrated more thoroughly into the Office of Management and Budget's management and budget processes, you testified against the Administration's proposal to merge OFPP into the management side of CMB.

- A. Do you believe that policy integration can be achieved without organizational integration?
- B. You indicated in your testimony that the OFPP lacks the authority to operate effectively. What additional authority would you recommend be given to OFPP?"

Yes, we believe that policy integration can be achieved without organizational integration. Of more immediate concern to our task forces was the necessity of separating policy and service functions.

The Office of Federal Procurement Policy (OFPP) was established to:

- o Be independent of any agency having procurement responsibilities.
- o Stand above the procurement agencies and have policymaking rather than advisory authority. OFPP was placed in the Office of Management and Budget to avoid the conflict-of-roles problem

experienced by the General Services Administration (GSA) with policy and service functions.

When policy and service functions are combined in one group -- where there is no unifying discipline such as a "bottom line" -- the group seems to divide the two functions into discrete areas and then vacillate between the two responsibilities, depending on management's priorities and the resources available. For example, this appears to have been the history of GSA over the recent past, and both "policy" and "service" have suffered.

The OFPP was created mainly due to the perception that a coherent Government policy was lacking in procurement. This is still the case.

While we recommended that OFPP be made part of the annual OMB budget review process, we did not recommend that OFPP become an organizational unit of OMB. OFPP should set policy and have regulatory review authority in the area of procurement, with GSA handling acquisition and distribution services.

In 1982, OFPP submitted a proposal for a Uniform Federal Procurement System (UFPS) designed to unify Government procurement policies, streamline the process, introduce greater



competition, improve professionalism, and clarify responsibility in the procurement management structure. Executive Order 12352 includes those procurement reforms which could be accomplished administratively, and various amendments enacted in 1983 and 1984 incorporate legislative elements of the UFPS. PPSS supports the UFPS, with the additional improvement of multiyear procurement.

The four major goals of the UFPS were:

- o streamlining and simplifying the procurement process through a single set of Federal Acquisition Regulations and increased use of simplified bid specifications,
- o emphasizing new concepts of competition based on total program costs,
- o establishing new standards of professionalism in the procurement work force through career management and development programs, and
- o creating in each agency an executive position responsible for procurement activities.

Achieving these goals requires:

- o a management structure with clear lines of authority and accountability, a simplified procurement process, a professional work force, and performance standards and feedback mechanisms (improvements in the Federal procurement work force, e.g., career programming, training, and long-range planning, are a focus of the 1986 Budget);
- o OFPP responsibility to put the new procurement system into operation;
- o legislation to bring Federal procurement practices into line with modern methods and requirements, ensuring that current policies are formalized and followed; and
- o OFPP policy authority over all agency procurement, authority to rescind agency regulations that do not conform to policy, and leadership responsibility to develop simplified government-wide regulations (government-wide regulations have been supplemented by agency-specific regulations which mitigate the positive impact of the Federal Acquisition Regulation initiative).

Implementing the above measures will enhance the role of OFPP concerning policy without it becoming a procurement manager. In particular reference to the last point, OFPP's authority to rescind regulations is extremely limited and involves both OMB and Congressional concurrence. Simplified procedures to ensure the consistency of agency regulations with overall Federal procurement policy would improve the effectiveness of OFPP. While much has been accomplished, much more remains to be done to reform Federal procurement practices.

## Question #6:

"The Grace Commission recommends that acquisition of 'common use' items, such as office equipment and supplies, should be centralized in the General Services Administration. The problem, as was discussed during the hearing, is that agencies frequently ignore GSA and buy their common-use items 'off schedule.' Joseph Wright agreed that agencies should be required to buy through GSA, when designated as the required source of supply, unless they have a compelling reason for not doing so.

- A. Are existing regulations adequate to establish GSA as a mandatory source of supply, and do they provide adequate controls for determining whether compelling reasons to buy 'off schedule' exist?
- B. What do you believe OMP should do to ensure that agencies are making maximum use of GSA?
- C. Is additional legislation necessary to clarify and/or augment GSA's authority with respect to procurement and supply management?"

Over the past 35 years, GSA has had limited success in establishing its credibility as an efficient central procurement source. We do not feel existing regulations can ensure that the situation will improve in the future. GSA's performance as an effective supplier of services to customer agencies will do more than regulations to ensure its use as a centralized procurement agent.

We feel GSA manages and supplies only a portion of the items which would appear to fall within the scope of such an agency. This is so, largely because GSA operates under several major handicaps which have limited its effectiveness, including:

- o The Administrator does not hold a cabinet rank, yet is charged with setting policy and regulations which govern the actions of cabinet members.
- o There is a significant lack of continuity at the head of GSA. Just at the moment when one management approach begins to move forward, it is replaced by new management objectives.

A major step toward improving GSA's procurement performance could be taken if GSA's responsibilities were focused solely on its service functions. This could be accomplished by transferring its current policy responsibilities to the Office of Federal Procurement Policy within OMB.

Improving the effectiveness of GSA's service function should in itself attract more business from other Federal agencies. However, OMB, with its enhanced policy role, should take an active role in ensuring maximum use of GSA for procuring non-defense items.

Legislation would be required to transfer GSA's current policy responsibilities to OFPP.

## Question #7:

"The Grace Commission found that many of the defense acquisition-related problems are rooted in the Defense Department's organizational structure. According to the Commission's Task Force report on the Office of the Secretary of Defense, there is a massive duplication of effort among the services, which could be remedied through consolidation of the acquisition management function.

A. How do you respond to Mary Ann Gilleece's criticism that 'it is false economy to attempt to "reorganize" your way out of problems?'

Ms. Gilleece's comment is accurate in some situations and not in others. It depends on whether a reorganization is used to mask other inefficiencies or whether, as in the case of the Defense Department, the current organization is the problem.

The fact is that DOD does not perform as well as it might, and there are some structural problems which contribute. Further, more good people will not necessarily make a significant difference unless the organization is designed to operate efficiently and economically.

While consolidating responsibility for the acquisition process would be a major undertaking, it would solve many problems. It would also transfer to OSD activities that can be best addressed by civilians, freeing military leadership for purely military functions. It would enable Congress to look to



a single source for comparative information on weapons alternatives, and it would assure evenhanded treatment of contractors.

In addition to the massive duplication of effort among the services and between the services and OSD, the current organization discourages optimization of total DCD procurement spending. Procurement funds are distributed by program among the three services, each of which operates independently of the others. Each service speaks for itself and defends its weapons programs against those of the other services.

Interservice rivalry for procurement funds compounds the problem. It appears that each service is inclined to underestimate proposed weapons systems costs, either to make its system appear more cost-effective than proposed systems of competing services, or to be allowed to start even more weapons.

Cost underestimation in the early stages of the acquisition process generally leads to successive changes in the cost estimates as the program moves through the acquisition phases. This factor, along with continual changes in the quantity procured, in production rates, in engineering designs, and in available funding leads to overall program instability. It has been estimated that approximately 20% of the actual cost of a weapons system represents costs associated with program instability.

PPSS suggested that a more centralized focus on the acquisition process at the OSD level would reduce instability in the process. OSD would be able to maintain the objectivity necessary to resist proposed instability changes in high priority programs. OSD's objectivity would allow elimination of marginal programs from the DOD budget, something the services are generally not able to do because of their vested interest in their own programs.

We feel that there are many efficiency and cost reduction benefits to be gained from implementing our recommended changes. Consolidation of acquisition functions would encourage implementation of the 32 initiatives in the Acquisition Improvement Program, provide a more objective basis for decisions to accept or reject proposed competing programs from the services, allow DOD to present a single position to Congress and the public on acquisition matters, and enable uniform procurement policies and procedures to be established to control the acquisition process.

It is of interest to note that the Center for Strategic and International Studies in its study "Toward a More Effective Defense" (which reflects the views of six former Defense Secretaries) reaches similar conclusions and makes similar recommendations on procurement reform.

"B. The Grace Commission's estimates of potential savings that would result from the consolidation of acquisition management within the Defense Department are unclear. According to the OSD Task Force report, the Commission claims no savings, but states that consolidated management could potentially save 'many billions, perhaps even tens of billions of dollars annually ... from better decision making.' You testified that the potential savings through implementation of this recommendation would be \$1.4 billion over three years. What is the Commission's estimate for potential savings to be achieved through this recommendation?"

The OSD Task Force savings of "tens of billions of dollars" are "benchmark" estimates only and were not included in our total savings estimates.

The \$1.4 billion in savings I presented in my testimony results from savings estimates for the following issues:

- Procurement-16 and OSD-16, Consolidate DCD contract administration activities and provide increased computer support. Estimated savings of \$483 million over three years.
- Army-16, Establish an organization at the staff level in the Army, responsible for promoting productivity programs. Savings estimate of \$892 million over three years.

- CSD-15, Improve the organization of the acquisition function. No savings claimed.
- Procurement-3, Implement the major Carlucci Initiatives (Acquisition Improvement Program).  
No savings claimed.

The total from the above five issues is \$1.375 billion in estimated savings over three years.

It is of particular interest to note that many of the PPSS defense-related recommendations are termed "unclear" by DCD, and they, therefore, did not provide savings estimates for our recommendations. The recent CBO report, "Reducing the Deficit: Spending and Revenue Options," includes procurement-related reforms claiming savings in the tens of billions of dollars. CPC states: "Because of the many items covered by these accounts, this report can not specify the detailed changes needed to achieve the savings discussed." This doesn't mean the savings can't be achieved. In fact, the CEO was able to estimate savings from their recommendations which, in many cases, are similar to ours. However, I would state that CBO's recommendations are "unclear" (and substantially more so) in exactly the same way as PPSS was "unclear."

"C. Ms. Gilleece testified that the Grace Commission ignored what the Defense Department believes would be very substantial implementation costs in terms of disruption of operations and displacement of people. Do you agree that there would be substantial implementation costs and, if so, did the Commission take these costs into consideration when recommending that acquisition management should be consolidated within the Defense Department?"

Preoccupation with near-term implementation costs is clearly a case of being "penny wise, dollar foolish" if the present organization structure is ineffective and inefficient. Ms. Gilleece's argument just doesn't hold water, and tens of billions of dollars are probably needlessly expended each year because of the reluctance to incur implementation costs.

DOD's weapons acquisition system is massive. The proposed total obligational authority for fiscal year 1983 was more than \$70 billion for purchasing aircraft, missiles, ships, combat vehicles, weapons, and torpedoes. Research, Development, Test, and Evaluation accounted for another \$24.3 billion.

There are 65,000 people in DOD who are directly involved in the acquisition process. In addition, personnel in the various commands support the acquisition function. The number of support personnel is difficult to determine, but a total DOD involvement of perhaps 500,000 people is not unlikely.

OSD must pass judgment on each proposed weapons system. However, there is a considerable body of evidence to suggest that it lacks complete data and has limited options available, since it is not as close to program planning as the services are.

Critics of the current weapons acquisition process make the following points:

- o DOD spends enormous amounts of money and time to obtain weapons that are on the leading edge of technology, but too few are available for use.
- o The lead time between conceptualization and development is too long.
- o Inadequate attention is paid to long-term affordability. Therefore, the trade-off between alternative weapons systems is made too late.
- o Whereas DOD personnel costs have somewhat more than doubled since 1974, and operations and maintenance costs have almost tripled, procurement costs are five times the 1974 level.

If this weapons acquisition process can be improved (and PPSS has proposed many ways it can), are we going to stop



and say implementation costs (even if billions of dollars) should stand in the way of greater weapons reliability and efficiency? Ms. Gilleece's comments just don't do any justice to the problem. The procurement system results in a lower degree of readiness and preparedness and costs billions more in cost overruns and stretch-outs, yet let's not suggest it be reformed.

## Question #8:

"Cost growth in major weapons systems is largely attributed to inaccurate cost estimates. Many experts believe that independent cost estimates will help curb cost growth, since these estimates have historically been more accurate than the program office estimates. As we discussed at the hearing, however, there appears to be some dispute between the Grace Commission's task force reports as to the utility of independent cost estimating. The OSD task force found independent cost estimates to be valuable, while the Procurement task force (which, contrary to your statement at the hearing, also dealt with weapons acquisition) did not.

- A. Given the OSD task force's findings, how do you explain the findings of the Procurement task force that the existence of independent cost groups in OSD and the services tends to diffuse the estimating effort and contributes to a lack of 'ownership' of, and ultimate accountability for, the program estimates?"

The Procurement Task Force states, on page 53:

"In an attempt to improve estimate accuracy, several independent groups have been established within each Service and DOD to review program estimates/schedules or prepare independent check estimates of program costs and schedule. The number of independent reviews conducted for major programs varies from Service to Service; generally there are two, one at the Service level and the other at the DOD level. In practice, this has resulted in several versions of program cost/schedule estimates at any given time. Generally, the highest estimate is selected or portions of individual estimates are combined into the resultant estimate which then serves as the program budget."

The OSD Task Force notes that:

"Despite the various independent estimates and reviews of program cost estimates which are

required, DOD has been continually faced with significant cost overruns on weapons systems acquisitions. The Selected Acquisition Report (SAR) of June 30, 1982, indicates that for 39 programs, cost estimating errors alone (exclusive of other elements contributing to cost growth, such as unanticipated inflation or engineering and quantity changes) amounted to \$10.8 billion, or about 9 percent of the original estimated cost of \$124.6 billion."

The problem is that DCD can not develop effective cost estimates and that no one is held responsible for ensuring accurate cost estimates. With no one person or group held accountable, the numerous cost estimating groups confuse, rather than clarify, the cost estimating and control process.

To clarify our position, PPSS is in favor of independent cost estimates rather than the projections of the services and defense contractors. The services and defense contractors have a vested interest in instituting and perpetuating individual weapons systems. A truly independent and objective cost estimate would be a step forward in the procurement program.

"B. The Procurement task force also stated that, in the private sector, the benefits of multiple reviews are not commensurate with the additional effort required. Do you agree?"

In the private sector, estimates are prepared and specific individuals or groups held responsible. So,

additional reviews add little, in that sufficient expertise was (or should have been) available when the estimate was prepared.

If a group consistently provides inaccurate estimates, the private sector solution is simple: they are fired. The private sector, as a result, can rely upon the cost estimates it produces.

The DOD can not rely on the cost estimates it produces. But more estimates don't help.

As the budgetary process is structured, there are pressures or incentives for producing low estimates. For example:

- o Early estimates are based largely on input from technologists who will not have a role in program implementation, so there is a tendency to see only the merits of new technology and overlook the risks and implementation difficulties they introduce.
- o Program Managers are judged in part by how well they convince their superiors that funding should be provided for their programs. Low estimates and short schedules aid this objective.

- o The services can get more programs started for a given funding level if estimates are on the optimistic side.
- o Program Managers feel that since program estimates are in the public domain, realistic estimates would be self-fulfilling, i.e., put them at a disadvantage in getting competitive bids from contractors.

An independent authority using modern techniques of estimating is necessary, and the DOD has just not set up the systems and controls to do that.

This involves more than piecemeal recommendations -- it involves a complete reorganization of the DOD purchasing system.

- "C. The Procurement task force found that part of the cost-estimating problem is that the background of personnel assigned to estimating is too heavily weighted toward business and accounting skills, while not enough emphasis is placed on technical qualifications. Do you agree that this is a problem and, if so, would assigning the cost-estimating responsibility to the Defense Department Comptroller, which the OSD task force recommends, exacerbate the problem?"

The DCD Comptroller should be able to obtain whatever personnel are necessary to develop accurate cost estimates --

accountants and/or technicians. Considering the importance of cost estimates and the highly technical aspects of weapons hardware and production, more emphasis on the technical side is warranted.

- \*D. Could you provide a detailed analysis of how the Grace Commission arrived at the projected three-year cost savings of \$18.3 billion through improved cost estimates, scheduling, and risk management techniques?

The issues included in this estimate follow:

- Procurement-6, Improve planning for weapons acquisition. Estimated three-year savings are \$2.940 billion.
- Procurement-7, Select contractors based on lowest "total cost" and improve efforts to monitor subcontracting. Three-year savings estimate of \$980 million.
- Procurement-8, Improve cost estimating and scheduling. Three-year savings estimate of \$2.940 billion.
- OSD-22, Improve estimates of weapons systems costs. No savings estimated.



- Army-10, Improve Army weapons acquisition systems. Savings over three years estimated at \$371 million.
- Army-11, Improve stability in procuring major Army weapons systems. Estimated savings of \$5.958 billion over three years.
- USAF-20, Extend use of dual-sourcing. Estimated three year savings of \$2.422 billion.
- Navy-3, Increase competition and reduce costs through dual-sourcing. Estimated three-year savings: \$1.020 billion.
- Navy-4, Encourage contractors to improve productivity. Estimated three-year savings of \$1.495 billion.
- Hospital Management-9, Reduce the amount of Federal hospital costs spent on the open market for medical supplies. Estimated three-year savings of \$222 million.

Total savings are estimated at \$18.348 billion over three years, and each issue includes a description of the methodology employed in projecting savings.

Question #9:

"In a recent article in The Public Interest, Professor Steven Kelman examined several allegations of waste by the Grace Commission and found serious logical and factual flaws in the Commission's analysis. These allegations examined by Professor Kelman were included in Commission materials entitled "Ten Random Examples of Bureaucratic Absurdity." How do you respond to Professor Kelman's article and the implication of his findings on the Commission's cost estimates?"

Our response to Steven Kelman is included as Attachment 3.

May 2, 1984

MEMORANDUM

CBO-GAO Analysis of  
PPSS Recommendations and Savings Estimates

At the request of the Senate Budget Committee, the Congressional Budget Office (CBO) and the General Accounting Office (GAO) conducted a joint analysis of the major savings proposals of the President's Private Sector Survey on Cost Control (PPSS). This study included a review of only 396, or 16.9%, of the 2,478 recommendations included in 47 PPSS Task Force reports. CBO-GAO developed savings estimates for only 274, or 11.1%, of total PPSS recommendations.

The CBO-GAO analysis was performed within the limitations imposed on them by their mandate from Congress:

- Unlike PPSS, which presented savings for the three years following full implementation, CBO-GAO estimated savings for fiscal years 1985, 1986 and 1987, those years covered by the Congressional Budget Resolution.
- CBO-GAO savings estimates were stated in relation to CBO baseline projections -- i.e., CBO-GAO estimates were of a budget quality compared to PPSS estimates,

which were of a planning quality, as has been repeatedly stated and emphasized in each of the published Task Force reports.

The CBO-GAO analysis found \$97.9 billion of PPSS savings possible over the 1985-1987 period. As CBO-GAO have stated, their analysis was limited in six ways:

- they only examined 16.0%, or the 396 biggest dollar recommendations, out of 2,478;
- the savings attributable to those 396 recommendations amount to \$379.0 billion over three years, or 69.5% of PPSS total estimated savings of \$545.0 billion (before eliminating overlap or duplication among issues);
- they did not assign savings for 122, or 30.8%, of these 396 recommendations;
- they did not review issues with three-year savings of less than \$1 billion each;
- the \$97.9 billion does not include savings which will occur in later years (FY 1988 and beyond); and
- the \$97.9 billion does not include savings which occurred in 1983 and 1984 or which are already in the 1985 budget.

Taking the CBO-GAO 1985-1987 savings estimate of \$97.9 billion for 274 recommendations and adding to it 1985-1987 savings estimates for (a) the 122 PPSS recommendations reviewed by CBO-GAO for which they did not project savings and (b) the remaining 2,082 PPSS recommendations not reviewed by CBO-GAO, results in total savings of \$246.9 billion for the specific three years, 1985-1987.

In addition, taking the (a) savings from issues for which recommendations become fully effective in years after 1987 (including the bulk of the savings through such items as changes in civilian and military retirement that become fully effective 10, 20, and even 30 years from now), (b) savings from PPSS recommendations already in place, and (c) interest savings computed using CBO's methodology, results in total savings of \$437.9 billion, as summarized in the following:

(Table on following page)

Potential Savings Per CBO-GAO and PPSS  
(\$ Billions)

|                                                                                               |             |
|-----------------------------------------------------------------------------------------------|-------------|
| Savings per CBO-GAO for 1985-1987                                                             | \$ 97.9     |
| Recommendations Studied by CBO-GAO<br>for Which They Did Not Include<br>Savings for 1985-1987 | <u>87.7</u> |
| Subtotal - Recommendations<br>Studied by CBO-GAO, 1985-1987                                   | \$185.6     |
| Recommendations Not Studied<br>by CBO-GAO, 1985-1987                                          | <u>61.3</u> |

|                     |         |
|---------------------|---------|
| Subtotal, 1985-1987 | \$246.9 |
|---------------------|---------|

|                                                        |                 |
|--------------------------------------------------------|-----------------|
| Recommendations for Later<br>Years Implementation      | 130.9           |
| Recommendations Already<br>Put in Place                | 23.0            |
| Additional Interest Using<br>CBO-GAO Method, 1985-1987 | <u>37.1</u>     |
| Total Savings                                          | <u>\$437.9*</u> |

\* Compares with \$424.4 billion in unduplicated savings in PPSS final report for the three years after full implementation.

The net of the preceding is that adding in PPSS savings for those recommendations not estimated by CBO-GAO results in savings greater than those claimed by PPSS -- \$437.9 billion in total, \$13.5 billion, or 3.2%, above the PPSS estimate of \$424.4 billion over three years.

Thus, with regard to numbers, CBO-GAO has looked at only part of the picture. While the CBO-GAO conclusions validate 25% of



PPSS savings, they do not invalidate the remaining 75%. Rather, the CBO-GAO analysis does not include the bulk of PPSS savings.

The preface to the CBO-GAO analysis states that "the report focuses on those recommendations that the Grace Commission estimated would have major budgetary savings." This limitation on the CBO-GAO mandate and analysis meant assessing a recommendation on its savings potential over the 1985-1987 period, analyzing only those recommendations to which PPSS assigned a budgetary impact, and reviewing only those recommendations that PPSS estimated could produce savings of \$1 billion or more over a three-year period.

PPSS provided over 600 recommendations which, if implemented, would improve the government's day-to-day performance, but for which no dollar savings were projected. Many of these improvement opportunities go to the heart of government operational efficiency -- its structure, systems, and people -- and are vital to the efficient management of the government's business and its future.

Thus, the CBO-GAO analysis did not cover some of the most important PPSS recommendations, particularly those contained in three PPSS reports, Federal Financial Management, Federal Management Systems, and Information Gap, which provide recommendations that are fundamental to improving the efficiency and effectiveness of government, but for which no savings were claimed by PPSS. Implementing PPSS recommendations in these three reports may well result in the largest savings of all through improvements in

management structures, systems, procedures, practices, methods, and controls.

Also, looking at only the three years, 1985-1987, as CBO-GAO did, means that recommendations with significant long-term savings potential were not considered in their estimated savings.

Further, if the impact of a recommendation could not be precisely measured against budgeted outlays, the CBO-GAO critique did not assign savings to it. In the PPSS response to the CBO-GAO report before Congress, each and every savings recommendation was related to specific budget items.

The present Federal budget accounting system could not be used to control a private sector company -- a company trying to use it would go bankrupt. But the Federal government has unlimited borrowing power, and the deficiencies in its accounting system -- a true misnomer since the Federal system aids and even encourages a lack of accountability -- can be masked by ever-increasing debt to cover ever-increasing Federal deficits.

This is a major point -- the accounting system which formed the basis for the CBO-GAO analysis is of limited usefulness as a cost-controlling mechanism. CBO-GAO analyses are based on budget authority (which authorizes spending) and outlays (actual spending). On- and Off-Budget outlays are estimated at \$870 billion for 1984. However, this is not fully representative of government

spending since the Federal accounting system nets, i.e., offsets, spending by related revenues. Federal obligations, a more meaningful measure of gross government spending, are estimated at \$1,240 billion in 1984, or 42.5% greater than outlays. Thus, CBO-GAO did not include \$370 billion of government activities (29.8%) in their totals for government spending.

Controlling costs by analyzing outlays (as CBO-GAO did with PPSS recommendations) is as inadequate as a private sector company reviewing its gross profit while ignoring the components (total revenues and total costs) which give rise to that profit.

If PPSS had reviewed the government, made recommendations, and calculated savings based only on the potential for near-term reductions in outlays and deficits, PPSS would have short-changed the President and the American public -- total government activity would have been 42.5% greater than that which PPSS reviewed.

It should be emphasized that the near-term budget reducing potential of a recommendation (i.e., how it affects outlays), which is the basis for the CBO-GAO analysis, is a wholly inadequate method for determining its merit. Even if CBO-GAO could substantiate only \$97.9 billion of PPSS savings over the next three years, with inflation of 6% and an interest rate of 11%, the \$97.9 billion supported by CBO-GAO becomes \$1.85 trillion in cumulative savings out to the year 2000. That's over \$3,400 a second over the next 17

years. PPSS did not want to fall into the trap of recommending actions which would result only in near-term savings.

A short-term perspective in both the Executive and Legislative branches is a major contributing factor to the current fiscal crisis.

For example, "stretching out" weapons acquisition programs (buying over a longer period of time than economically and effectively desirable) can save money in the short run, but adds to the total costs long-term. Similarly, "solving" perceived payroll problems by providing salary continuation through pensions (which are three and six times the pension benefits available in the private sector) while keeping current salaries "low" saves money now, but adds to total long-term costs.

PPSS recommendations on Civil Service and Military Retirement Systems are indicative of the problems PPSS encountered in evaluating recommendations within the context of the Federal accounting system, the short-term government perspective, and inadequate Federal accounting practices.

Granting excessively liberal retirement benefits to Civil Service employees was a more politically palatable solution to the perceived problem of noncompetitive Federal salaries than raising wages. Increasing salaries would have resulted in an immediate increase in outlays, while the costs of increased retirement benefits are largely in the future.

So, the government increased retirement benefits instead of increasing salaries. And as it shifted costs into the future, it failed to recognize that money should be put aside now to pay for these costs as they become due.

The Federal government fails to accrue for future pension liabilities, as is mandatory in the private sector. PPSS recommended changes in Federal Retirement Systems which could save \$58.1 billion over three years. CBO-GAO estimated savings of \$6.9 billion, 1985-1987. If the Federal government kept its books as the private sector does, the PPSS savings attributed to retirement recommendations of \$58.1 billion would be realized over the next three years, since the expense to which those savings related would, by law, be recognized in financial statements. The government, however, understates its current employment costs by neither fully recognizing nor reserving for its future pension liabilities.

Today, American taxpayers face a trillion dollar plus unfunded liability in the Civil Service and Military Retirement Systems which we will bequeath to our children and grandchildren -- largely as a result of our reliance on a governmental process and related Federal accounting system which fails to meet many of the fundamental purposes of an accounting system, such as recognizing the total cost of Federal employees while they render service.

So, the impact of our retirement recommendations on the government's budget is described by CBO-GAO as "relatively modest"

over the 1985-1987 period since outlays are not significantly reduced, even though savings 20 years from now will be billions of dollars annually. The current situation is one where neither increasing nor decreasing retirement benefits has much impact on near-term outlays and deficits, yet either move has very significant political repercussions and large future budgetary impact. In this regard, it is of interest that the GAO, in testimony before the Senate Budget Committee, stated that there are "needed improvements in the financial management structure of the government as a whole."

Further, CBO-GAO's failure to put a recommendation into budgetary terms says nothing about its quality. GAO expressed an opinion on 325 of the 396 recommendations reviewed, or 82.1%, and found merit with about 75% -- regardless of savings impact.

Another area in which PPSS savings were denigrated as unrealistic and overstated concerned the issue of "policy."

Almost all the waste and inefficiency PPSS found in the Federal government can be traced to systems failures and restraints put on the management of the Executive Branch by the Congress. There is hardly anything basic in the management of government operations that doesn't require Congressional approval, be it closing obsolete facilities, buying new computers, the wage scale on Federal construction projects, or just about anything that might result in greater efficiency, including policy decisions in the Veterans Administration affecting as few as three employees.

In this regard, CBO-GAO stated that "the bulk of the cost savings estimated by the PPSS are associated with proposals to change policies or to restructure programs."

Considering Congressional "micromanagement" of Executive Branch operations (i.e., involvement in the smallest details of management), it is virtually impossible to differentiate policy and operational recommendations.

For example, is it Congressional policy to supply free towing services to yacht owners, as the Coast Guard does? If this "policy" were submitted to a voter referendum, who would vote for it? This is an item included in the CBO-GAO analysis as a policy initiative, while PPSS believes this is a prime example of an unjustifiable subsidy -- program waste of taxpayers' money.

As another example, it is policy to feed hungry children -- a policy with which PPSS is in complete agreement. However, when the same child is fed through the Food Stamp program, the School Lunch program, and other child nutrition programs, and PPSS identifies and recommends discontinuing unnecessary, overlapping, and duplicative benefits, is it policy or operations?

PPSS thinks operations; CBO-GAO thinks policy.

Is it Congressional policy to pay duplicative benefits? If it is, the taxpayers should be so informed. PPSS believes that,



rather than intentionally duplicating benefits, a well-thought-out, well-managed program would meet its objectives more efficiently and more effectively.

In addition to the conceptual handicaps within which GAO-CBO performed their work, as has been detailed above, their interpretation of some PPSS recommendations is clearly incorrect or misleading.

Under Tax Federal Subsidies (this is the CBO-GAO title for this issue; the primary thrust of PPSS recommendations in this area was not taxing subsidies but rather more efficient "targeting" -- i.e., more efficiently helping those for whom benefits are intended), PPSS estimated three-year savings of \$58.9 billion assuming full implementation, with no savings for the 1985-1987 period.

CBO-GAO estimated \$7 billion in additional revenues, 1985-1987, from taxing benefits to individuals and business under various Federal subsidy programs.

CBO-GAO misinterpreted the PPSS recommendations and the basis for the savings calculations. PPSS projected no additional revenues from taxing government subsidies.

Included under the broad category of subsidies are expenditures for means-tested programs for the poor such as Aid to

Families with Dependent Children, Food Stamps, and Medicaid. To combat a "Poverty Gap" of \$50.1 billion (the difference between the poverty level and the incomes of subsidy recipients in means-tested programs), 1982 Federal, state, and local spending on these programs amounted to \$124 billion.

Thus, there is the anomaly of means-tested assistance programs covering the poverty gap 2 1/2 times. This clearly indicates that, insofar as assistance is directed to overcoming poverty, it is very inefficient. As a further example, in 1981, \$81.5 billion, or 69.8%, of all means-tested benefits were paid to recipients above the poverty level.

Despite the large amounts spent, adequate information does not exist to determine the degree to which the intended recipients of these subsidy programs are receiving sufficient benefits or, conversely, the degree to which benefits are being bestowed upon undeserving recipients to the detriment of all taxpayers. Indeed, there is no way to identify all the subsidies a particular beneficiary receives.

The problem is that there is a huge information gap exacerbating inadequate subsidy management. The large number of programs, decentralization of responsibilities, lack of coordination among administrative and legislative functions, and complex, inconsistent, and sometimes conflicting program eligibility criteria, contribute to a lack of control.

PPSS analyses showed that despite 1982 Federal, state, and local spending of \$124 billion on these programs, the "poverty gap," estimated at \$50.1 billion, was reduced by only \$37.4 billion -- a little over 30¢ on the dollar.

PPSS recommended that a form, similar to the W-2 form issued to wage earners, be issued by each Federal department or agency providing subsidies. A copy of this proposed form would be submitted to the Internal Revenue Service, and an individual's total earnings, wages and cash, and in-kind subsidies could be determined. This form would provide the means to determine whether Federal subsidy benefits are meeting their objectives or, conversely, benefiting those who do not need or merit subsidies.

PPSS recommendations (basically to reduce or eliminate mistargeting of benefits which result from lack of information and inadequate coordination of benefits) would save an estimated \$31.9 billion, or 7.1%, of 1983 Federal subsidy obligations of \$448.6 billion. Within the context of well documented statistics on waste and error in these programs, these savings estimates are comparatively modest and are unlikely to adversely affect the benefits of any legitimately qualified recipient.

Under Reduce Civil Service Retirement Benefits, PPSS estimated savings of \$8.1 billion for the 1985-1987 period, as compared to \$6.4 billion for CBO-GAO.

The CBO-GAO analysis contends that private sector retirement costs as calculated by PPSS are understated. They further argue that because PPSS proposals to change Civil Service retirement benefits do not include all three types of retirement income found in the private sector (pension plan, capital accumulation plan, and Social Security), GAO does not endorse the PPSS recommendations as based on representative private sector practices or as sound personnel policy for Federal employees.

Supporting the CBO-GAO claim is a March 1983 study showing the government's cost of retirement and disability programs at 17.1% of payroll in March 1980 assuming adoption of typical private sector retirement practices. The 17.1% of payroll estimate was prepared by the Office of Personnel Management (OPM), and the specific assumptions with regard to private sector practices are unspecified. The OPM estimate of 17.1% compares to a PPSS estimate of private sector retirement costs of 12% of payroll based on three separate surveys which analyzed retirement costs in more than 1,000 companies. Further, PPSS considered all private sector benefits, including Social Security and capital accumulation plans, in comparing private sector and CSRS benefits.

The current CBO-GAO analysis adjusts the OPM estimate of 17.1% to reflect alternative assumptions to those of OPM and arrives at a cost of 22.8% of payroll for government retirement costs assuming adoption of typical (but again unspecified) private sector practices.

While "typical" costs can be debated endlessly, the government's actual retirement cost is more than 30% of payroll, and that is dramatically understated because of the half-trillion dollar unfunded liability of the Civil Service Retirement System.

Many issues developed by PPSS can be argued from a variety of viewpoints; however, the one unarguable point is that the Civil Service Retirement System provides its recipients lifetime benefits several times those available under the best private sector plans, as CBO has determined through its own analyses, which have been published in other reports.

Regarding the PPSS recommendation to Repeal or Modify the Service Contract Act, CBO-GAO estimates savings of \$121 million, 1985-1987, compared to PPSS savings of \$2.2 billion over the 1985-1987 period.

CBO estimated savings are substantially below those of PPSS primarily because CBO uses a Labor Department estimate that only 10% of the value of service contracts are attributable to labor costs. This portion of service contracts attributed to labor costs appears absurdly low and generates the lower savings estimates. Several other sources of savings estimates documented by PPSS -- including an estimate by GAO -- are all significantly higher.

PPSS believes that a more accurate estimate of the labor cost component of Federal service contracts is at least 75%. If the

labor component were actually as low as 10% for services such as security, sanitation, etc., then the Federal government should seriously reevaluate its contracts.

Overall, PPSS agrees that CBO-GAO did a reasonable job in evaluating PPSS recommendations. However, their conclusions in no way invalidate the work of PPSS because of the limited and short-term CBO-GAO focus and, in some cases, because of inaccurate analyses.

TABLE II-2  
PPSS REPORTS  
Attachment 2  
DUPLICATED SAVINGS AND REVENUE ENHANCEMENT OPPORTUNITIES  
THREE YEAR TOTALS BY FUNCTION  
(\$ Millions)

| FUNCTIONAL AREAS AFFECTED             | (1)<br>SAVINGS     | (2)<br>REVENUE   | (3)<br>TOTAL       |
|---------------------------------------|--------------------|------------------|--------------------|
| 1. Federal Retirement Programs        | \$37,322.2         | \$ 0.0           | \$37,322.2         |
| 2. Weapons Systems Acquisition        | 14,351.6           | 0.0              | 14,351.6           |
| 3. Medicare/Medicaid                  | 8,940.0            | 0.0              | 8,940.0            |
| 4. OMB Circular A-76                  | 8,807.7            | 0.0              | 7,964.0            |
| 5. Automated Data Processing/OA       | 7,964.0            | 0.0              | 7,964.0            |
| 6. Power Marketing Administration     | 785.3              | 5,833.8          | 6,619.1            |
| 7. Federal Subsidies                  | 6,392.5            | 0.0              | 6,392.5            |
| 8. Inventory Management-Military      | 6,033.0            | 0.0              | 6,033.0            |
| 9. Commissary Operations              | 3,481.7            | 0.0              | 3,481.7            |
| 10. Davis-Bacon Act                   | 3,330.5            | 0.0              | 3,330.5            |
| 11. Service Contract Act              | 2,383.0            | 0.0              | 2,383.0            |
| 12. Research and Development          | 2,286.6            | 0.0              | 2,286.6            |
| 13. Weapons Systems Cost Estimating   | 1,883.0            | 0.0              | 1,883.0            |
| 14. Coast Guard Services-User Fees    | 1,259.4            | 418.2            | 1,677.6            |
| 15. Walsh-Healey Act                  | 1,671.5            | 0.0              | 1,671.5            |
| 16. Veterans Admin. Hospitals         | 1,436.5            | 0.0              | 1,436.5            |
| 17. Military Base Support             | 918.0              | 0.0              | 918.0              |
| 18. Military Health Care              | 744.7              | 0.0              | 744.7              |
| 19. Spare Parts Break-out             | 689.4              | 0.0              | 689.4              |
| 20. Tax Exempt Bonds                  | 0.0                | 662.0            | 662.0              |
| 21. Cash Management                   | 492.2              | 0.0              | 492.2              |
| 22. Unnecessary Military Bases        | 337.0              | 30.0             | 367.0              |
| 23. Cargo Preference Act              | 457.5              | 0.0              | 357.5              |
| 24. Foreign Military Sales            | 0.0                | 248.2            | 248.2              |
| 25. Recreation Fees                   | 0.0                | 226.9            | 226.9              |
| 26. Debt Collection Management        | 180.0              | 19.3             | 199.3              |
| 27. FCC User Charges                  | 0.0                | 132.4            | 132.4              |
| 28. Freight Transportation Audit      | 130.2              | 0.0              | 132.2              |
| 29. Public Rangelands/Grazing Fees    | 0.0                | 125.4            | 125.4              |
| 30. Direct Lending Phaseout-SBA/FMHA  | 100.0              | 0.0              | 86.5               |
| 31. Government Printing Offices       | 99.3               | 0.0              | 99.3               |
| 32. Vehicle Fleet Management          | 86.5               | 0.0              | 86.5               |
| 33. Small Business Act Sec 8(a)       | 76.8               | 0.0              | 76.8               |
| 34. Military Moves to Alaska & Hawaii | 69.5               | 0.0              | 69.5               |
| 35. Military Reserves Dual Pay        | 66.2               | 0.0              | 66.2               |
| 36. Firewood Fees                     | 0.0                | 63.6             | 63.6               |
| 37. Government Employee Travel        | 51.5               | 0.0              | 51.5               |
| 38. Annual Loan Guaranty Fee          | 0.0                | 42.7             | 42.7               |
| 39. Direct Loan Application Fees      | 0.0                | 23.2             | 23.2               |
| 40. Soil Survey Fees                  | 0.0                | 22.5             | 22.5               |
| 41. Consumables Management-Military   | 20.0               | 0.0              | 20.0               |
| 42. Purchase of Foreign Currency      | 17.1               | 0.0              | 17.1               |
| 43. Max Loan Guaranty Rate-SBA/FMHA   | 11.2               | 0.0              | 11.2               |
| 44. Military Accrued Leave Pay        | 6.3                | 0.0              | 6.3                |
| 45. Certified Lenders' Program        | 4.2                | 0.0              | 4.2                |
| TOTALS                                | <u>\$112,786.1</u> | <u>\$7,848.2</u> | <u>\$120,634.3</u> |



## PPSSCC Audit Memo on Duplicated Savings

September 1, 1983

TO: J.P. BOLDUC

Control #39.1

FROM: R.L. MOON

SUBJECT: WEAPONS, SYSTEM ACQUISITION

| Task<br>Force | Data<br>Source<br>Used | Claimed Savings (\$ millions) |             |             |                | Type | Category |
|---------------|------------------------|-------------------------------|-------------|-------------|----------------|------|----------|
|               |                        | Year<br>-1-                   | Year<br>-2- | Year<br>-3- | Total<br>3 Yrs |      |          |
| PROC-4        | Final<br>Report        | 500.0                         | 1,100.0     | 1,815.0     | 3,415.0        | S    | I        |
| PROC-6        | Final<br>Report        | 300.0                         | 325.0       | 1,815.0     | 2,940.0        | S    | I        |
| PROC-7        | Final<br>Report        | 100.0                         | 275.0       | 605.0       | 980.0          | S    | I        |
| PROC-9        | Final<br>Report        | 100.0                         | 275.0       | 605.0       | 980.0          | S    | I        |
| OSD-22        | Final<br>Report        | -----Note 1-----              |             |             |                |      |          |
| OSD-23        | Final<br>Report        | 1,051.5                       | 2,313.3     | 3,816.9     | 7,181.7        | S    | I        |
| USAF-19       | Final<br>Report        | 800.0                         | 800.0       | 800.0       | 2,400.0        | S    | I        |
| NAVY-1        | Final<br>Report        | 1,000.0                       | 1,000.0     | 1,000.0     | 3,000.0        | S    | I        |
| NAVY-2        | Final<br>Report        | 250.0                         | 250.0       | 250.0       | 750.0          | S    | I        |

## Control #39.1 continued

| Task Force | Data Source Used | Claimed Savings (\$ millions) |          |          |             | Type | Category |
|------------|------------------|-------------------------------|----------|----------|-------------|------|----------|
|            |                  | Year -1-                      | Year -2- | Year -3- | Total 3 Yrs |      |          |
| NAVY-4     | Final Report     | 325.0                         | 585.0    | 585.0    | 1,495.0     | S    | I        |
| ARMY-10    | Final Report     | 342.0                         | 752.4    | 1,517.3  | 2,611.7     | S    | I        |
| ARMY-11    | Final Report     | 2,000.0                       | 2,200.0  | 2,420.0  | 6,620.0     | S    | II       |

Note 1/ OSD report combines OSD-22 and OSD-23 savings into OSD-23 savings summary

|                    |          |          |          |           |   |
|--------------------|----------|----------|----------|-----------|---|
| Duplicated Savings | -3,348.4 | -4,686.4 | -6,316.8 | -14,351.6 | S |
|--------------------|----------|----------|----------|-----------|---|

PROC-4 Addresses cost savings through increased Multi-Year Procurement (MYP). The weapons procurement portion of PROC-4 savings is \$2,958 million.

PROC-6 Recommends timely development of comprehensive program management and acquisition plans at the program level. Addresses significant savings from early determination of weapons system planning and earlier affordability decisions.

PROC-7 Recommends OSD streamline and make more efficient and effective the existing source selection process.

PROC-9 Recommends more effective use of the program management organization/services in each Service.

OSD-22 OSD-22 addresses the establishment of procedures for earlier and more accurately estimated weapons costs. Earlier determination of weapons systems affordability is addressed as having significant cost saving potential. Stability of weapons systems procurement through firm defense and fiscal guidance is also addressed. Savings resulting from more timely requirements development duplicates savings in PROC-6. Streamlining of the source selection process is duplicated in PROC-7. Savings for OSD-22 are combined into OSD-23.

- OSD-23      OSD-23 addresses stability in the weapons acquisition Economic Order Quantity (EOQ), Multi-Year Procurement (MYP), and more effective use of the Program Manager (PM) and his organization. The MYP of weapons systems is duplicated in PROC-4. The more effective use of the Program Manager is duplicated in PROC-9.
- USAF-19      Addresses Multi-Year Procurement in the USAF. This issue duplicates savings in issue PROC-4.
- NAVY-1      Addresses stability of weapons systems procurement through firm defense and fiscal guidance and the bringing together of the programming and budgeting phases. This portion of Navy-1 overlaps issue PROC-6. Navy's recommendation to restrict the number of programs in production to those it has the ability to fund at FOC (Economic Order Quantity) is duplicated in PROC-4 and OSD-23. (All savings for NAVY-1 are related to the EOQ issue.)
- NAVY-2      Addresses Multi-Year procurement for weapons systems acquisition. This issue duplicates savings in PROC-4 and OSD-23.
- NAVY-4      Addresses creating incentives for weapons contractors to substantially increase their capital investments in equipment and facilities. No overlap with other procurement issues exists.
- ARMY-10      Addresses weapons systems cost savings from improved cost estimating, reduced requirement changes, and separation of procurement and production organizations. Reduced requirement changes are duplicated in PROC-6 and OSD-22. According to data contained in ARMY-10 these reduced requirement changes amount to 13.7 percent of the ARMY-10 savings, or \$357.9 million. (Improved cost estimating is duplicated in PROC-8).
- ARMY-11      Addresses weapons procurement stability through use of improved SAP's, a biennial budget for weapons, full auditing of cost growth, and a change in guidelines for reprogramming of monies. Improvement of SAP's is duplicated in PROC-6 and OSD-22. The other savings are not duplicated. A conservative estimate of overlap between ARMY-11 and PROC-6 is 10% or \$662 million.

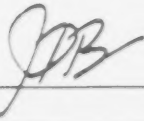
Control #39.1 continued

Comments: For purposes of removing the duplicated savings the following savings of \$14,351.6 million will be removed on a top-side basis in the final report to the President.

|               | <u>YR 1</u> | <u>YR 2</u> | <u>YR 3</u> | <u>TOTAL 3 YRS</u> |
|---------------|-------------|-------------|-------------|--------------------|
| OSD-<br>22/23 | 1,051.5     | 2,313.3     | 3,816.9     | 7,181.7            |
| USAF-19       | 800.0       | 800.0       | 800.0       | 2,400.0            |
| NAVY-1        | 1000.0      | 1000.0      | 1000.0      | 3,000.0            |
| NAVY-2        | 250.0       | 250.0       | 250.0       | 750.0              |
| NAVY-4        | 0.0         | 0.0         | 0.0         | 0.0                |
| ARMY-10       | 46.9        | 103.1       | 207.9       | 357.9              |
| ARMY 11       | 200.0       | 220.0       | 242.0       | 662.0              |
|               | 3,348.4     | 4,686.4     | 6,316.8     | 14,351.6           |

Savings as stated in the individual task force reports will remain unchanged.

Verified by



Date verified



Agree as stated above



Amend as noted

RLH/im/lah

## PPSSCC Audit Memo on Duplicated Savings

September 1, 1983

TO: J.P. BOLDUC

Control #39.2

FROM: R.L. MOON

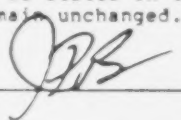
SUBJECT: WEAPONS, COST ESTIMATING

| Task<br>Force         | Data<br>Source<br>Used | Claimed Savings |             |             | millions)    |      |          |
|-----------------------|------------------------|-----------------|-------------|-------------|--------------|------|----------|
|                       |                        | Year<br>-1-     | Year<br>-2- | Year<br>-3- | Total<br>Yrs | Type | Category |
| PROC-8                | Final<br>Report        | 300.0           | 825.0       | 1,815.0     | 2,940.0      | S    | I        |
| ARMY-10               | Final<br>Report        | 342.0           | 752.4       | 1,517.3     | 2,611.7      | S    | I        |
| Duplicated<br>Savings |                        | -246.6          | -542.5      | -1,097.9    | -1,883.0     | S    |          |

PROC-8 Recommends improved estimating, scheduling, and risk management techniques to improve the costing and scheduling estimates of weapons systems.

ARMY-10 Addresses weapons systems cost savings from improved cost estimating, reduced requirement changes, and separation of procurement and production organization. Reduced requirement changes are addressed in OSD-22. Improved cost estimating is duplicated in PROC-8. According to information contained in ARMY-10, the improved cost estimating portion of savings is 72.1%, or \$1,883.0 million (.721 x 2,611.7).

Comments: For purposes of removing the duplicated savings, ARMY-10 savings of \$1,883.0 will be removed on a top-side basis in the final report to the President. Savings as stated in the individual task force reports will remain unchanged.

Verified by 

Date verified \_\_\_\_\_

☒

Agree as stated above

☐

Amend as noted

RLM/im

## PPSSCC Audit Memo on Duplicated Savings

September 6, 1983

TO: J.P. BOLDUC

Control #39.3

FROM: R.L. MOON

SUBJECT: WEAPONS DUAL SOURCING

| Task<br>Force | Data<br>Source<br>Used | Claimed Savings (\$ millions) |             |             |                | Type | Category |
|---------------|------------------------|-------------------------------|-------------|-------------|----------------|------|----------|
|               |                        | Year<br>-1-                   | Year<br>-2- | Year<br>-3- | Total<br>3 Yrs |      |          |
| USAF-20       | Final<br>Report        | 341.9                         | 736.2       | 1,344.0     | 2,422.1        | S    | II       |
| NAVY-03       | Final<br>Report        | 340.0                         | 340.0       | 340.0       | 1,020.0        | S    | I        |

-----  
 Duplicated  
 Savings

No Duplicated Savings  
 -----

USAF-20 Recommends Defense Acquisition Regulations be reviewed  
 or expanded regarding dual sourcing.

NAVY-03 Recommends Navy maintain at least two competitive  
 sources during the entire production life of weapons  
 systems programs.

Comments: These two issues address dual sourcing in the  
 respective Service. No overlap exists.

Verified by


☒ Agree as stated above

Date verified

☐ Amend as noted

RLM/lm

Comments on  
"The Grace Commission: How much waste in government?"  
An Article in the Winter, 1985  
Edition of The Public Interest, By Steven Kelman

Mr. Kelman's article in the winter edition of The Public Interest was based upon a two-page press release issued in January 1984 when the final report of the President's Private Sector Survey on Cost Control (PPSS) was delivered to the President. Mr. Kelman concludes from his research that waste in Government was greatly exaggerated by PPSS; therefore, cutting waste cannot substantially reduce the deficit.

However, review of Mr. Kelman's limited analysis reveals both factual and conceptual errors which invalidate his conclusions. Though PPSS went to great lengths to ensure the accuracy of our reports, we cannot deny the potential for errors in the more than 21,000 pages of documents that were published, nor in the 1.5 million pages of material used during the research for those reports. However, despite this qualification, the inescapable fact is that waste and inefficiency do exist in Government, and exist on a massive scale.



In the conclusion of his article, Mr. Kelman states that inefficiencies in Government do not result from the "incompetence and venality" of Federal employees, thus implying that this was a PPSS finding. It was apparently not important to Mr. Kelman that Federal employees were never blamed by PPSS for inefficiencies and were, more often than not, praised for their dedication and performance under the constraints of a seriously flawed system.

After building this straw man, and then mercilessly knocking it down, Mr. Kelman declares a victory over the myth of waste in Government.

To correct any problems that may exist, Mr. Kelman offers some general recommendations which would undoubtedly benefit any large organization. For the record, all of the curatives prescribed by Mr. Kelman were similarly identified in specific and general cases in the various PPSS reports. Curiously, this does not come across in his article.

For whatever reason, Mr. Kelman has attempted to soothe the conscience of Congress by reassuring them that waste and inefficiency in Government are not major contributors to the deficit. Of course, this assumes that any excess can be legitimized simply by calling it "policy." Carrying this designation, waste and inefficiency are considered by Mr. Kelman to be immune from review or correction.

For example, the press release on which Mr. Kelman based his research included ten examples that were labeled "bureaucratic absurdities." Mr. Kelman did not discuss four of these ten examples because he considers them "policy" rather than bureaucratic absurdity. Looking at these four items, Mr. Kelman obviously does not find it absurd that:

- o Congress prohibits competitive bidding for Defense Department shipments of household goods between the mainland and Alaska and Hawaii, even though such competition could save taxpayers \$70 million over three years.
- o Congress obstructs the closing of military bases even the Defense Department finds unnecessary, including one in Virginia that is surrounded by a moat.
- o Congress prevents the replacement of post offices that serve less than 100 customers with equal but less costly alternatives.
- o 70% of the borrowers from the Farmers Home Administration are not farmers.

In the PPSS review, waste and inefficiency, whether resulting from accident or design, was addressed.

Under "The Horror Stories" which Mr. Kelman did discuss were the following:

"(1) 'The Pentagon has been buying screws, available in any hardware store for 3 cents, for \$91 each.'"

Mr. Kelman states:

"...it turns out that the Defense Department has not negligently allowed itself to be hoodwinked. Most of these cases have a common explanation, which involves an accounting quirk in pricing material purchased from contractors.

"Often in the past, contractors have, simply as a matter of accounting convenience, allocated the overhead to the individual parts on an 'item' basis rather than a 'value' basis."

Mr. Kelman appears to have accepted, without further investigation, the conventional wisdom that explains away gross overcharges as resulting from overhead allocations. In this story line, it's the contractor's accounting system that's the villain, since it allocates overhead equally to all units in a shipment, regardless of relative value. However, no such allocation system exists, and if it did, it would be contrary to stated DOD regulations, and therefore, illegal. Mr. Kelman uses a hypothetical example to illustrate his system, because real examples cannot be found. The real explanation for these astronomical prices is simply that the DOD and the taxpayers are being abused. Prices are high because the Defense Department rarely questions what it is charged.

For example, Dr. Thomas Amlie, Defense Department Assistant for Technical Systems, has found that most contractor labor charges fall in the range of \$150-\$300 per standard labor hour, with some as high as \$3,405 per hour. By comparison, private sector companies generally pay \$30-\$35 per standard labor hour for machine shop work and \$20-\$25 per hour for electronics manufacturing. Thus, if three hammers are assembled in an hour by a defense contractor, the allocated labor cost at \$300 per hour will be \$100 per hammer (under similar circumstances, the cost to a private sector purchaser would be \$7-\$12 per hammer).

While this may appear as a nightmare to the taxpayer, according to Mr. Kelman:

"...nothing horrible has occurred. The total overhead represents real resources legitimately charged to the government."

The inherent problem in Defense procurement is that actual costs are assumed to be reasonable costs, regardless of how unreasonable they may appear broken down item by item. But getting such detailed cost information is very difficult. Contractors are not willing to make this information available, for obvious reasons, and Defense Department program managers rarely pursue this information aggressively.

Program managers are eligible for retirement with immediate unreduced pensions after 20 years of service. They

may supplement their retirement income by working for the contractor for whom they had oversight responsibility as program manager -- apparently a common occurrence in view of the 799 retired military officers hired by the top ten defense contractors in 1982.

It is interesting to contrast this situation with that of France -- the world's third largest arms exporter and arguably the most efficient -- where it is against the law for program managers to work with companies for which they had oversight responsibility within the previous five years.

The incentives for "playing by the rules" in the DOD procurement organization are hard to resist. And even if one were to resist and blow the whistle on waste, the general perception is that such a course of action is likely to be met by harassment from higher levels of management. A 1983 survey by the Merit Systems Protection Board revealed that 69% of Federal workers were exposed to waste but did not report it for fear of retribution.

What is not clear is why Mr. Kelman chooses to support this system. Mr. Kelman finds only one problem with his mythical cost allocation system:

"There is one mildly distressing aspect of this practice. The spreading of overhead costs over a contractor's entire production appears to reduce the up-front costs of new weapons systems, since research and development for the weapon is charged to spare parts as well."

Again, Mr. Kelman is not correct. Research and development is done under separate contracts, using different appropriations. Charging research and development to a production contract is illegal.

The next item reviewed by Mr. Kelman was as follows:

"(2) 'In comparison to a private sector company, managing comparable building space, the General Services Administration employs 17 times as many people and spends almost 14 times as much on total management costs.'"

In this case, Mr. Kelman states our background information exaggerated the relative inefficiency of the General Services Administration (GSA) versus the private sector in regard to building management. The comparisons with a private sector company were made to highlight the need for careful management of the Government's facilities. Duplication of responsibilities and functions and numerous rules, regulations, and laws inhibit the Government from carrying out this task effectively. Mr. Kelman did not address the issue, nor did he state whether the PPSS recommendations were good or bad.

Mr. Kelman met with GSA officials on March 26, 1984, and was told that the comparison he was working on had no bearing whatsoever on the merits of the recommendations or the estimate of savings. He was also told by GSA that they found the Grace Commission recommendations on this issue sound and

were in the process of implementing them. Mr. Thomas J. Simon, Director, Office of Program Initiatives at GSA, and with whom Mr. Kelman met on March 26, states that Mr. Kelman's failure to mention his discussions with GSA "does a grave disservice to the Grace Commission, GSA, and most importantly, the American taxpayer." Overall, the 76 recommendations from the Grace Commission which concern GSA, and which they are implementing, could save the taxpayers \$6.4 billion over three years.

Mr. Kelman did mention that "GSA officials would themselves concede that they probably have a larger staff for comparable functions than a private-sector counterpart" and states, "...it is difficult to play around with these figures to arrive at a genuine comparison." We leave it to Mr. Kelman to "play around with the figures." We, instead, chose to work toward correcting the problem.

Concerning the Veterans Administration, Mr. Kelman questions the following comparison:

"(3) 'The VA spends \$61,250 per bed to construct nursing homes -- almost four times the \$16,000 per bed cost of a major private sector nursing home operator.'"

Mr. Kelman states:

"The Grace Commission averaged the cost of six VA nursing homes, and the average was raised dramatically by the reported \$113,500 per bed cost of construction of a home in Martinsburg, West Virginia. This nursing home was being built simultaneously with a VA hospital adjacent to it,



and the cost the Grace Commission reported included construction costs for a domiciliary that was part of the whole medical center, as well as site preparation and utilities for the entire complex. The actual cost for the nursing home at that site was \$29,000 per bed, bringing the average cost per bed for the six facilities down from \$61,000 to \$47,000. Furthermore, the cost of three of the other VA homes was raised significantly because of unfavorable site conditions (such as confined space for construction, requiring off-site warehousing of materials). Site conditions were unfavorable because the nursing home was being built contiguous to an already existing VA hospital, pursuant to VA policy. The average cost of the three hospitals built under normal site conditions was \$39,000 a bed."

To derive the nursing home cost comparison, PPSS used average costs for six VA nursing homes, two constructed in 1980 and four in 1981. The private sector average was derived from two nursing homes constructed in 1981, and three in 1982. Since the two lowest cost (per bed) VA nursing homes were constructed in 1980 and the three most expensive private nursing homes were constructed in 1982, a more equitable VA/private sector comparison would be between the four VA and two private sector nursing homes constructed in 1981. The cost comparison (\$54,025 per bed for VA versus \$13,093 in the private sector) shows VA costs 4.1 times as great. The Martinsburg nursing home, constructed in 1980, is excluded from this comparison.

Mr. Kelman continues:

"...various quality differences increase the cost of a VA nursing home relative to a private one.

"The most obvious differences involve the physical designs. VA facilities have been top-of-the-line. Homes have routinely included balconies in each room, occupational therapy areas, quiet rooms, extensive recreation space, and on-premises artwork. The VA policy of building homes contiguous to VA hospitals rather than freestanding, as the private company Beverly does is also quality-driven: it provides nursing home residents quick access to hospital services and allows rapid treatment of medical emergencies.... Is it worthwhile to produce such a high level of quality? That is a matter of debate. But it is not an issue of waste as the term is typically used."

Mr. Kelman is wrong; the debate concerns waste, not policy. Private nursing home operators are as concerned as the VA about access to medical facilities in case of emergencies. And most private nursing home facilities are adequate, although they could not be termed luxurious. The private sector has to consider cost and affordability in constructing nursing homes, and has to trade "wants" against available funds. The VA is under no similar constraint.

Decisions to locate VA nursing homes near VA hospitals are not based on cost analyses nor even on medical necessity. (Nursing homes, after all, treat patients with long-term illnesses, usually not requiring immediate medical care.) The decision is a political one, with taxpayers paying for the lack of analysis and attention to cost. Further, PPSS recommendations make the argument over access to medical care moot. PPSS recommended that underutilized VA hospital beds be converted to nursing beds. Medical care would, therefore,

always be immediately available. However, VA nursing home patients would, probably, have to forego balconies, artwork, and other amenities.

Mr. Kelman points out that in 1981 the high cost of constructing VA nursing homes began to be called into question:

"In 1981 the VA established a task force on nursing home construction cost reduction, after private nursing home chains had called the cost differences to the attention of Congressional oversight committees. The task force proposed a number of design changes that will reduce the cost of new VA nursing homes by about \$12,000 per bed."

The VA didn't act until Congress pressured it to do so. And Congress didn't act until private companies brought the cost differences to its attention. PPSS, and even Mr. Kelman, found a VA system so bureaucratic it takes external pressure to reduce costs. Yet, Mr. Kelman doesn't think PPSS should disturb this giant (asleep at the wheel), but should let it drive on.

The tremendous waste which accumulated in the VA program is apparent in that \$12,000 in construction costs per bed can be saved without reducing services, but by eliminating unnecessary amenities. In a 120-bed facility, savings amount to \$1.4 million.

Mr. Kelman attributes any residual cost difference to policy rather than waste. If you label something as "policy," then you don't have to answer questions like:

- Why can't VA nursing homes be constructed a mile or two away from VA hospitals to avoid unfavorable site condition costs of \$8,000 per bed?
- Why do VA patients need balconies, nine foot ceilings, and expensive artwork and landscaping?
- What management mechanisms has VA established to control costs?
- What responsibility does Congress have to ensure taxpayer money is wisely spent?

Mr. Kelman did not bother to look at what PPSS recommended regarding VA nursing home construction. PPSS recommended that the VA convert underutilized hospital beds to nursing home beds; that where necessary, the VA hire private companies to design, build, and operate nursing homes; and that the VA Office of Construction improve its management policies, procedures, organization, and staffing, and introduce incentives to reward cost-efficient performance.

VA nursing home residents would get optimal care, in existing medical facilities, at no added cost (and substantial savings). Further, incentives would be established to limit costs, within a cost-conscious organization. PPSS recommendations are consistent with Mr. Kelman's and the VA's concerns over adequate care, good facilities, and efficient procurement.

Mr. Kelman attacks other PPSS findings regarding the VA as follows:

"Perhaps the most dramatic was that it costs the VA \$140 to process a claim for hospital coverage, compared to \$3-\$6 for private-sector insurance companies. This is wildly inaccurate. The Grace Commission listed the General Accounting Office as its source, but the GAO denies ever having made such a calculation. Dividing the total number of claims the VA processes by the dollar cost of claim processing expenditure yields a cost of \$5-\$7 per claim."

In February 1982, the VA analyzed its administrative costs to process bills for health care services provided veterans at private community hospitals. Costs to process each bill were estimated at \$109 for FY 1980.

During the 1980-1983 period, medical costs increased by 34.4%. Applying this increase to the \$109 cost calculated by the VA for 1980, results in 1983 costs of \$147. The \$140 cost is described by PPSS as an estimate, and it conforms to an updated estimate of VA costs, per the VA's own study.

Mr. Kelman is incorrect in categorizing the PPSS statistic as "wildly inaccurate."

Mr. Kelman continues:

"The other Commission criticism involved the method of storage for supplies procured through national contracts. Since the 1940s, the VA has operated central warehouses to supply individual hospitals. Products are delivered directly to warehouses and transported to individual hospitals as they are ordered. Advances in distribution technology, the Commission stated, have made warehouses uneconomical; proprietary hospital chains, the report said, have rejected warehousing.

"The VA presents different figures. It claims that running the warehouses adds only 15% to costs, not the 30% that the Grace Commission claimed. The VA claims that this 15% cost is more than made up by the lower prices that suppliers offer for single-point delivery to warehouses rather than multiple-point delivery to individual hospitals. They point to several studies by the General Accounting Office and the VA Inspector-General supporting the cost-effectiveness of the depots.

"Top management of the VA is unsure enough of what is going on to have now commissioned an outside consulting study on the warehouses."

Perhaps the most amazing statement in Mr. Kelman's argument is that "the VA is unsure enough of what is going on to have now commissioned an outside consulting study on the warehouses."

The "horror story" regarding VA purchases of medical supplies is not only excessive costs, but that top management

doesn't even know if it is overpaying for supplies. Amazingly, Mr. Kelman dismisses this lack of information (fundamental to managing the VA) by commending the VA for now beginning to study the problem.

Calculations support the PPSS position that depot costs represent an overhead expense of 30%, not 15% as the VA claims. During the first nine months of 1982, the value of VA supplies sold by the depots to hospitals was \$83.3 million. Depot operating costs were \$22.7 million, an overhead rate of 27.3%, which is much closer to a 30% cost to maintain the depots than the 15% estimated by VA.

In addition, the depot system may encourage hospitals to carry excessive inventory. For example, to minimize transportation expense, VA depot system regulations preclude hospitals from ordering more frequently than monthly (bimonthly in the case of some large medical centers). This inflexibility requires hospitals to carry more inventory to meet safety levels between order cycles.

PPSS found that the VA hospitals hold 45 to 60 days of inventory when they should more reasonably hold the 30- to 45-day inventory held in private hospitals.

In sum, the cost of operating a depot and tying up capital in inventory is not rewarded with either efficient



service or inventory reduction at hospitals. Other organizations, within both the Federal government and the private sector, are satisfied that the best pricing is achieved through aggressive negotiation on national contracts. Any additional discounts that might be gained by large, one-time orders do not offset depot costs.

Mr. Kelman also looked into the following:

"(4) 'The government spends almost \$5 billion annually on freight charges but doesn't bother to negotiate volume discounts with suppliers.'"

Mr. Kelman states that the GSA had investigated automated freight traffic services in 1981, but it wasn't until 1983 before they "decided to procure one [a system], and the system they selected went on-line in March 1984." PPSS recommendations were made prior to GSA's actions to improve freight management.

In any event, the thrust of this issue seems to be missed by Mr. Kelman. The need for better procedures for freight traffic management resulted from deregulation in 1980, which simultaneously introduced competition, thereby lowering tariffs while complicating the process of selecting alternative carriers, routes, tariffs, tenders, and contracts in the industry. That the bureaucracy reacted to the situation four years later would not appear to warrant too much elation among the taxpayers.

PPSS emphasized the importance of the Government taking advantage of the increased competition resulting from deregulation. More information is required regarding the expanded number of local and regional carriers, the services offered, and the rates and routes available. Therefore, coordination is necessary to improve Government automation for traffic management and to take full advantage of the Government's huge freight volumes, in order to manage traffic more efficiently and negotiate favorable rates.

Mr. Kelman also researched the following:

"(5) 'Government mailing lists erroneously repeat the same addresses as many as 29 times.'"

PPSS noted that there has been no Government-wide effort to reduce the cost of unnecessary mailings by canvassing (i.e., correcting and updating) mailing lists, although individual agencies and subagencies have taken certain initiatives.

As an example of the potential savings, PPSS found that by canvassing and consolidating its mailing lists, the Office of Human Development Services of the Department of Health and Human Services made possible immediate annual savings of \$1.2 million in printing and postage costs. From 128 separate mailing lists containing 90,000 addresses, HDS developed a single list with 29,000 names after eliminating duplications, deceased persons, erroneous listings, and persons

not interested in receiving HDS publications. Similarly, mailing list problems exist in other agencies. Thus, canvassing and consolidating mailing lists is replicable in other Government agencies.

In regard to how bad the situation is, Mr. Kelman states:

"At worst, as the person in charge of the reform effort told me, an addressee appearing 29 times might receive five copies of a single publication -- but only in the rare cases when a mailing went to several of the agency's different lists. There were certainly some examples of duplications on the same list: Although federal law requires annual canvassing of individual agency lists for duplication, compliance is mixed."

It is interesting to note that Senator Mathias, Vice Chairman of the Joint Committee on Printing, is on record as saying 1,084 copies of one free publication, "NASA Tech Briefs Journal," were sent to one large company, at a cost to the taxpayer of \$8,672 for each new issue. In addition, 938 copies of that publication are sent to a second company and 630 are sent to a third company. Mr. Kelman's "person in charge of the reform effort" should be sure not to overlook this area.

In any event, a system which allows 300 separate mailing lists in one bureau, in one agency and yet fails to establish professional list management is the problem which should be addressed. Redundant distributions of publications is a symptom of that problem.

- (6) "The Justice Department just sits on the cash seized from criminals, not bothering to deposit the money in interest bearing accounts while cases are being adjudicated."

In regard to the above, Mr. Kelman states:

"Traditionally, cash seized from criminals was indeed not deposited in interest-bearing accounts. 'Not bothering,' however, was not the reason. Attorneys prosecuting cases wanted the actual bills in hand to gain the dramatic impact on juries of displaying wads of ill-gotten lucre. Depositing the money would have meant losing the ability to show it to juries: all that would have been available would have been a statement in a government bank account! Furthermore, some jurisdictions require that actual bills be submitted in evidence."

The total value of assets seized in 1982 was \$317 million, of which approximately 25%, or \$79 million, was in the form of cash. The necessity of having the seized bills available to obtain an indictment is certainly debatable, particularly in view of the foregone interest cost of \$50 million over three years.

Beyond this, because of inadequate management systems, the Justice Department has allowed the value of non-cash assets seized -- totaling \$238 million in 1982 -- to depreciate in a range of 45% to 65% between the time of seizure and the time of disposition.

Mr. Kelman notes:

"The local U.S. Attorney offices had no capability to manage seized assets while they

awaited disposition ... and no centralized management system had ever developed because there were so few seized assets."

If Mr. Kelman had read the report by the PPSS Task Force on the Justice Department, he would have found this problem was identified and it was recommended that a special unit be formed within the Department to assume full responsibility for maintenance of all assets.

Mr. Kelman notes that this responsibility is just now being conferred on the U.S. Marshals Service, with cash to be put into bank accounts. He describes this action as if it were happening independently of the PPSS recommendations in this area.

Mr. Kelman also fails to tell us why cash can be deposited now, whereas previously it could not. We would suggest that PPSS recommendations provided the impetus to overcome the preference of prosecuting attorneys for evidence with "dramatic impact."

Mr. Kelman also discussed the following:

- (7) "HUD makes only 3 attempts to collect loans versus 24 to 36 tries in the private sector."

Mr. Kelman's comments on PPSS findings regarding the loan collection efforts of the Department of Housing and Urban

Development are intended to indicate that these efforts are more extensive than records indicate. For example, he notes:

"...HUD loan collection officers generally do not make a written record of telephone calls they make to delinquents, so Grace Commission investigators looking only at the written record underestimated the number of collection tries HUD made."

This is a weak justification of HUD's collection activities. If no record is kept of collection attempts, who is to say what degree of effort was made? How is the performance of the individual responsible to be evaluated? This is typical of the information gap that is pervasive in Federal operations.

Mr. Kelman adds:

"...for the Section 312 loans that HUD makes directly, Fannie Mae (the Federal National Mortgage Association), which services the loans, engages in some mild collection activity (dunning letters but no phone calls or contacts with an employer) before passing the loans on to HUD."

The point of PPSS review in this area was to establish that Federal collection efforts were largely ineffectual. For example, defaulting on money owed the Government did not affect one's credit rating, nor did it prevent borrowing from a different Federal lending agency. It was the recommendation of PPSS that agencies be allowed to contract with private sector collection agencies to collect defaulted debts. This authority was provided in subsequent legislation, the Debt Collection Act.

From our perspective, the information provided by Mr. Kelman does nothing to detract from the necessity of our recommended changes. On the contrary, as Mr. Kelman states:

"Finally, at least for Section 312 loans, management at HUD has probably always regarded these loans as a sort of disguised social assistance program and has seen the idea of banging on the doors of poor people to get them to pay as distasteful. Loan collection efforts for the 312 program traditionally got little attention from top management."

It is not for management of HUD's loan program to decide what is a loan and what is "disguised social assistance." This decision is made by Congress. As for finding loan collection to be a "distasteful" activity, this is why debt collection agencies have evolved in the private sector. They do not find debt collection to be distasteful, they find it profitable.

In almost all cases where PPSS found the Government offering direct and guaranteed loans for similar purposes -- e.g., student loans, housing loans, etc. -- the guaranteed loan program administered by a private sector lender was invariably more efficient insofar as collecting on money owed. Our Government was not intended to be a lending institution (particularly when it is lending money it doesn't have to people who can't afford to borrow), and Mr. Kelman's comments highlight this fact.



We can only guess as to what Mr. Kelman's motives were in writing this article. However, we do know that his comments do a grave disservice to the 77 million taxpayers of this country, who just might resent having their money wasted, whether as a result of operating inefficiencies or legislative policy.

6-

## Mystery of the \$436 Hammer

There is a type of news story that seems to attract a good deal of attention from the news media and the public. It's called the outrage story, and it typically involves descriptions of situations in which human stupidity, unfairness, arrogance or greed have reached a level so blatant it cannot be ignored.

If you're a regular newspaper reader, you've seen hundreds of such stories over the years. Whistleblowers are persecuted for revealing health hazards; "welfare queens" drive up in Cadillacs to pick up food stamps; a phone company sends a deaf man without a telephone a bill, to name a few generic examples.

Recently, the press and public have been delighting in an outrage story that seems to out-outrage most previous examples. The military, which we rely on to be quick and keen-sighted, seems to have been making mistakes any smart 15-year-old would avoid. In fact, it has been starting to look as if somebody must have been asleep at the ledger book while subcontractors walked off the with the mint.

In article after article, it was revealed that the military had purchased three-cent screws for \$91 apiece, hammers for \$436 apiece, and coffee pots for \$7,622 apiece. Last September, the military reportedly said it had uncovered numerous cases of waste and fraud that occurred since 1981 and admitted those cases might represent only the tip of the iceberg.

Clearly, the outrage story was being taken to new levels of outrageousness. Or was it?

On Feb. 2, *The Post* ran a column by George Will, a columnist for the *Washington Post*, that made the whole thing look like a misunderstanding on the part of the news media and the Grace Commission, which issued a report on how the government can save money. Will's column was based on an article in *The Public Interest* by Steven Kelman of the Kennedy School of Government that said the inflated prices are usually the result of an "accounting quirk," rather than overcharges.

Kelman argued that when the military signs a contract to receive goods, the firm often allocates certain overhead costs to every product in the contract, and it allocates the cost equally between every item. That means a \$25,000 item and a 4-cent item each may have \$100 in overall contract costs added on to the actual cost of the item. The \$25,000 item is now listed as costing

### Listening Post

Ken Saran



\$25,100 and the four-cent item suddenly looks like it is costing \$100.04.

"Although this produces horror stories, nothing horrible has occurred. The total overhead represents real resources legitimately charged to the government," Kelman wrote.

If Kelman's thesis were correct, then normally priced items only looked inflated in cost and the real outrage was the press' gullibility and failure to properly research a story before going to press.

After Will's column appeared, *The Post* received a thick package of documents in the mail from a Pentagon watchdog group called the Project on Military Procurement. Inside was a startling assertion. The accounting system described by Kelman has never existed and no one has ever been able to produce a single example of it ever being used, the group said. The notion that such a system existed appeared in an Air Force study, was passed on by an Air Force lieutenant colonel to Kelman, picked up by columnist Will and sent by him to readers around America. But, according to the information in the package, it was all fiction.

In putting an end to the accounting method, "it appears that the DOD has successfully solved a procurement problem that never existed," a project letter said.

Kelman's article and the information provided by the Project on Military Procurement provided two opposite views on something that should be a matter of fact. Which was the fiction — the inflated costs or the accounting system used to explain the costs? To find out, I called those involved in the controversy, little suspecting that I was about to find myself in the middle of a war over costs that is going on inside the military itself. I'll tell you what I discovered Sunday.

*Palm Beach Post - Feb. 22, 1985*

# The War Inside the Pentagon

Has the U.S. military been paying \$91 for 3-cent screws and \$436 for \$15 hammers? In the last few years, many news stories have described such absurd and apparently inflated purchases, leading to a good deal of embarrassment on the part of the military, and to calls for reform of military purchasing systems.

But as we reported Friday, Harvard Professor Steven Kelman has cast doubt on whether the actual costs are really inflated. Kelman claims the high prices are merely the result of an "accounting quirk" that allocates overhead costs to many items in a contract on an equal basis. A four-cent item that has \$100 in legitimate contract overhead added on, only looks on paper as if it cost \$100.04.

Further confusing the situation, a Pentagon watchdog group called the Project on Military Procurement has responded by saying it is the accounting method described by Kelman that doesn't exist. Those are real, overinflated prices, the group says.

To discover the truth, we called Kelman, who was careful to disentangle himself from any ideological camps in the controversy: "I have never worked for the Pentagon. I have no ax to grind. I was really acting as you are, as a reporter," he said. "I am opposed to some of the things the Pentagon has done."

Kelman admitted he made what he called a semantic error in referring to the costs at issue as overhead, but otherwise, he stood by his story.

"I think it's fair to say sometimes those joint costs are padded," he said. "That padding is not going to get a three-cent screw to \$91. It might get a 3-cent screw to 3 1/4 cents."

Next, we called Lt. Colonel C.E. Messamore, a source of Kelman's information. Messamore referred us to a publicist who referred us to Tom Mahler, a major in the Air Force contract pricing office involved in formulating purchasing policies. If anyone would know, Mahler would.

"The reality lies somewhere between the two extremes," Mahler said. The system described by Kelman does explain "a significant" number of the inflated costs, but the military has also been overpaying, by purchasing items from contractors who then purchase the items elsewhere, by ordering special items when mass produced items will do, and by engaging in other inefficient practices, he said.

Mahler's solution seemed to make sense: Kelman is partially right and the Project on Military Procurement is partially right. Everyone gets a little and loses a little, shakes hands and leaves friends.

We thought, perhaps, we had settled the issue. Then we called the Project for Military Procurement which referred us to an expert named Ernest Fitzgerald.

"There is no accounting system they can produce that does anything remotely like what Professor Kelman talked about," Fitzgerald said. "... It is a diversion to get people's minds off the fact that we are simply being ripped off."

Many contractors want to get military contracts at whatever cost the military is willing to pay, Fitzgerald told us. At times, they try to justify prices by spreading a total inflated price amid many items in the contract. Behind overpriced items there is an overall, overpriced contract.

## Listening Post

Ken Sanes



"We're going to run down every example they come up with, and so far they are turning out more horrible than we thought," he said. "The pliers is going to be a riot."

Then came a surprise — Fitzgerald, it turns out, is a "management systems deputy" in the office of the assistant secretary of the Air Force for financial management, and here he was, telling us another Air Force spokesman was obfuscating an issue. We were in the middle of a war over waste that is taking place not merely between the news media and the establishment, but inside the American military establishment itself.

As a result of recent publicity, Fitzgerald said he was instructed by Assistant Secretary of the Air Force for Financial Management Richard Carver to make a report on the alleged accounting system. The two factions on the issue met Feb. 13 and no one was able to produce an accounting system of the type described, Fitzgerald said.

We called Mahler back and pressed the point. He agreed the term accounting system might not be the best term.

"It's a pricing system. It's a pricing technique," he said.

"I guess our bottom line is we have reservations about the amount of allocated direct cost (spread to different items)," Mahler said. "We became concerned about what in fact we were paying for and what in fact we were getting for our money."

Mahler's description was starting to sound more like Fitzgerald's. We had started with an accounting quirk that explained why some apparently inflated expenditures were reasonable. We had ended up with a "pricing technique" that was itself apparently used by some contractors to spread artificially inflated costs in a total contract.

The basic problem, says Fitzgerald, is a philosophy that says a reasonable price for an item is whatever it cost the contractor to make it, plus a reasonable profit. If contractor costs are high due to inefficiency or unnecessary expenditures, or if the contractor merely says it cost that much to make, too often the military still pays.

The military could save \$30-\$40 billion a year if it would reform its purchasing practices, he said. If Fitzgerald is even partially correct, it's not hard to figure out why those at the top might prefer to let those below fight over the matter, instead of becoming involved themselves in an issue that could become political dynamite.

In any case, the next time you read a horror story about wildy exaggerated military purchases made with your hard-earned tax dollars, feel free to be outraged and to get a good laugh out of it. You might as well get something for your money.

WILLIAM V. ROTH, JR., DEL., CHAIRMAN  
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 JEFF BINGHAM, N. MEX.  
 DAVID PRYOR, ARK.

## United States Senate

COMMITTEE ON  
 GOVERNMENTAL AFFAIRS  
 SUBCOMMITTEE ON  
 OVERSIGHT OF GOVERNMENT MANAGEMENT  
 WASHINGTON, D.C. 20510

SUBCOMMITTEE  
 WILLIAM S. COHEN, MAINE, CHAIRMAN  
 WARREN S. RUSSMAN, N.H. CARL LEVIN, MICH.  
 JOHN C. DANFORTH, MO. JEFF BINGHAM, N. MEX.  
 SUSAN M. COLLINS, STAFF DIRECTOR

February 12, 1985

The Honorable Joseph R. Wright  
 Deputy Director  
 Office of Management and Budget  
 Executive Office Building  
 Washington, D.C. 20503

Dear Joe:

Your testimony before the Oversight Subcommittee was extremely helpful in our evaluation of the Grace Commission's recommendations for procurement reform. To follow up on our January 23 hearing, we ask that you respond to these additional questions for the record.

1. The Grace Commission's savings estimates for each of the ten procurement recommendations evaluated by the Oversight Subcommittee are listed on page four of Mr. Bolduc's prepared statement (enclosed). Would you provide for the record the Office of Management and Budget's savings estimates for each of these recommendations and, where different from the Commission's estimates, explain why?
2. The proposed merger of the Office of Federal Procurement Policy into the management side of OMB is, as you know, of paramount interest to the Oversight Subcommittee. To facilitate the Subcommittee's consideration of this merger proposal, would you provide for the record the Administration's legislative proposal necessary to accomplish the merger, as well as the OMB's specific plans for how this merger would be implemented?
3. You testified that the proposed merger will "make the [OFPP] more effective, give it greater stature, and integrate it more thoroughly into the OMB budget and management processes."
  - A. How would this merger enhance the OFPP's effectiveness and stature?

- B. Why is the organizational integration of OFPP into OMB necessary to accomplish the policy integration recommended by the Grace Commission?
- C. The Commission on Government Procurement listed "responsiveness to Congress" as one of the OFPP's major attributes. Will integrating the OFPP more thoroughly into OMB necessarily limit the Office's responsiveness to Congress?
- 4. If, as you testified, the procurement "division" of OMB no longer would warrant a separate Senate-confirmed administrator, doesn't this imply that procurement management is being downgraded?
- 5. Unless Congress approves the merger proposal, the law still requires a presidentially appointed administrator.
  - A. When does the Administration expect to submit a nomination for this post?
  - B. Do you also plan to fill the SES position for Associate Administrator for Policy, which has been vacant since last November?
- 6. Short of merging the OFPP into OMB, what other steps can be taken to enhance the Office's effectiveness and stature? Would you reconsider your position on restoring the OFPP's full regulatory authority which, as you previously testified, the Administration opposed on the basis that the Office had sufficient authority to operate effectively?
- 7. The Grace Commission recommends that the thresholds for socio-economic programs should be uniform and tied to the \$25,000 small purchase procedure threshold to lessen their impact on the acquisition process. As a step in that direction, you stated in your testimony that the OFPP is proposing a test to exempt small purchases from socio-economic programs at selected procurement activities.
  - A. Would you provide a copy of the OFPP's test proposal for the record?
  - B. What do you hope to accomplish through this test?
  - C. What criteria would be used for determining the success of the test?

8. You pointed out in your testimony that the Federal Acquisition Regulation represents a substantial reduction in the thousands of pages of procurement regulations. While this may be true, many experts are nonetheless concerned that the proliferation of agency supplements to the FAR, which total nearly twice the pages of the FAR itself, will lead us back to where we started. How can we ensure that, with time, the FAR system will improve, rather than get worse?
9. You stated that the OFPP is responsible for reviewing agency supplements to ensure against inconsistent, as well as unnecessary, supplementation.
  - A. What has OFPP done to date to fulfill this responsibility?
  - B. While we believe that OFPP should play a central role in reviewing agency supplements, can the office adequately assume this labor-intensive responsibility given its limited resources?
  - C. Can we entrust the agencies to "police" their own regulations?
10. The Grace Commission recommends that acquisition of "common use" items, such as office equipment and supplies, should be centralized in the General Services Administration. The problem, as we discussed during the hearing, is that agencies frequently ignore GSA and buy their common-use items "off schedule." You agreed that agencies should be required to buy through GSA, when designated as the required source of supply, unless they have a compelling reason for not doing so.
  - A. Are existing regulations adequate to establish GSA as a mandatory source of supply, and do they provide adequate controls for determining whether compelling reasons to buy "off schedule" exist?
  - B. What is OMB doing to ensure agencies are making maximum use of GSA? Are there penalties for not complying with GSA regulations or instructions?
  - C. Is additional legislation necessary to clarify and/or augment GSA's authority with respect to procurement and supply management?

We have also enclosed questions from Senator Rudman which he would like answered for the record.

Again, we appreciate your assistance in evaluating the Grace Commission's procurement recommendations, and we ask for your reply to our questions by February 26, 1985.

Sincerely,

  
William S. Cohen  
Chairman

  
Carl Levin  
Ranking Minority Member

Enclosure



PPSS Three-Year Savings Estimates — Procurement

|                                                                                                                                             | (1)<br>Savings<br>(\$ Millions) | (2)<br>% of Total |
|---------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|-------------------|
| ( 1) Enhance the role of the<br>Office of Federal<br>Procurement Policy                                                                     | NO SAVINGS ESTIMATED            |                   |
| ( 2) Improve the organization of<br>the acquisition function<br>within the DOD                                                              | \$ 1,375                        | 1.7%              |
| ( 3) Centralize the acquisition of<br>"common use" items through<br>the GSA                                                                 | 312                             | 0.4               |
| ( 4) Lessen the impact of socio-<br>economic programs on the<br>acquisition process                                                         | 12,497                          | 15.0              |
| ( 5) Encourage implementation of<br>OMB Circular A-76 on<br>contracting out                                                                 | 7,390                           | 8.9               |
| ( 6) Simplify the regulatory<br>requirements                                                                                                | 644                             | 0.8               |
| ( 7) Enhance competition in<br>contracting through the use<br>of functional or performance<br>specifications                                | 7,423                           | 8.9               |
| ( 8) Improve cost estimates,<br>scheduling, and risk<br>management techniques                                                               | 18,348                          | 22.0              |
| ( 9) Increase stability in the<br>acquisition process through<br>greater use of multiyear<br>contracting                                    | 3,415                           | 4.1               |
| (10) Improve program management by<br>strengthening the role,<br>responsibility, authority, and<br>accountability of the<br>program manager | <u>1,285</u>                    | <u>1.5</u>        |
| (11) Total ten areas above                                                                                                                  | \$52,689                        | 63.3%             |
| (12) Other related issues                                                                                                                   | <u>30,567</u>                   | <u>36.7</u>       |
| (13) Total                                                                                                                                  | <u>\$83,256</u>                 | <u>100.0%</u>     |

Questions submitted by Senator Rudman

Your testimony citing the Administration's strong support for Circular A-76, is consistent with the Grace Commission's recommendation to enhance contracting-out efforts. The Grace Commission also clearly supports the underlying principle of reliance on the private sector and it appears that President Reagan has similar views on the issue of contracting-out. He has been quoted, for example, as saying "The truth is that outside of its legitimate function, government does nothing as well or as economically as the private sector of the economy."

There appears, however to have been a recent shift in policy, at OMB, one which emphasizes government competition with the private sector rather than one which encourages the contracting out of commercially available services. Mr. David Muzio of your staff, in at least one public appearance, described OMB's policy as having the basic thrust of making the government a "more viable competitor" and "to make the government more capable." With this in mind, I would appreciate responses to the following questions and concerns:

1. Why is OMB now willing to potentially increase the role of government by permitting government agencies to compete with the private sector for work being contracted out by other government agencies? I would appreciate a detailed justification of the benefits to the taxpayers involved in this policy shift, including copies of any studies done by OMB or other agencies on this subject.

2. When making recent revisions to OMB Circular A-76, why was the 10 percent penalty on the bids of private companies retained?



EXECUTIVE OFFICE OF THE PRESIDENT  
OFFICE OF MANAGEMENT AND BUDGET  
WASHINGTON, D.C. 20503

MAR 29 1985

Honorable William S. Cohen  
Chairman  
Subcommittee on Oversight of  
Government Management  
Committee on Governmental Affairs  
U.S. Senate  
Washington, DC 20510

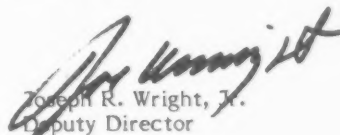
Dear Mr. Chairman:

This is in reply to the joint letter of February 12, 1985, in which you and Senator Levin requested additional information regarding our assessments of certain recommendations of the President's Private Sector Survey on Cost Control.

Enclosed are our responses to the 10 questions posed by you and Senator Levin, and to the two questions asked by Senator Rudman with respect to our productivity improvement program.

I am pleased that our testimony on January 23 before the Oversight Subcommittee was helpful. Please let me know if we can be of further assistance.

Sincerely,

  
Joseph R. Wright, Jr.  
Deputy Director

Enclosures

## QUESTIONS OF SENATORS COHEN AND LEVIN

### Question No. 1

The Grace Commission's savings estimates for each of the ten procurement recommendations evaluated by the Oversight Subcommittee is listed on page four of Mr. Bolduc's prepared statement (enclosed). Would you provide for the record the Office of Management and Budget's savings estimates for each of these recommendations and, where different from the Commission's estimates, explain why?

**Answer:** Before we address the estimates attributed to the Grace Commission (also known as the President's Private Sector Survey on Cost Control - PPSSCC) for each of the ten recommendations, we would like to include in the record the generic reasons that PPSSCC estimates and OMB budget estimates necessarily differ. The PPSSCC estimated \$424.4 billion in unduplicated three-year savings (including revenue enhancements). To provide a managerial view of the magnitude of potential savings, the PPSSCC generally counted these savings from the first year of full implementation.

If savings are to be incorporated into budget estimates, they must be related to specific fiscal years. Nearly all of the PPSSCC information gathering on which dollar savings were estimated occurred in 1982 and, as is indicated above, the PPSSCC estimates of dollar savings were based on three years after full implementation and were made for unspecified fiscal years within the period 1982 to 2003.

Moreover, the PPSSCC savings estimates were based on whatever empirical method made sense to team members for management decision-making purposes. Although the PPSSCC made an overall attempt to use obligations, there were a large number of teams with various financial and business backgrounds. Thus, the measures they used, which are quite appropriate for management improvement reports, included present value discount, cost avoidance, economic subsidy values, and internal cash flow - not the budget measures used to determine the deficit, i.e., budget receipts and outlays.

As a result, PPSSCC dollar savings associated with recommendations that have budget policy significance in the 1986 budget must be translated into budget measures and specific fiscal years if they are to be incorporated into the budget.

This translation has been made for dollar savings that have budget policy significance in the 1986 budget.

For budget purposes, the savings (and increased revenues) that are associated with the PPSSCC recommendations have been differentiated, as follows:

- o Recommendations that have been implemented with the 1985 or prior budgets are included without further identification in the 1986 budget base, as part of the 1986 current services baseline. No further actions by the President or Congress are required. No attempt has been made to estimate the budget amounts that would have been in the budget baseline if these recommendations had not been implemented. Current estimates of savings from actions already completed would be highly judgmental, would be more confusing than enlightening, and would not have budget policy significance. Therefore, the PPSSCC dollar estimates for these savings are used.

- o Independent estimates of savings have been made for recommendations that are included for the first time in the 1986 budget. Adoption of these recommendations result in lowered appropriation requests for 1986 and succeeding years. Accordingly, estimates of budget savings are provided in tables of Appendix B of the Management Report of the United States, Fiscal Year 1986, to facilitate Congressional review.
- o Recommendations that are under further study will require budget estimates for the fiscal years in which the management improvements are proposed to take place. No savings from these recommendations are reflected in the budget estimates. Adjustments for the affected fiscal years will be calculated and made later for those recommendations that the President decides to adopt.

Now we will address the Bolduc estimates of PPSSCC savings for each of the ten items.

**Item (1).** Enhance the role of the Office of Federal Procurement Policy. No savings estimated.

**OMB Assessment.** We concur in the recommendation of the PPSSCC (PROC 1) and, like the Commission, have made no estimate of savings.

**Item (2).** Improve the organization of the acquisition function within the DoD. The the Bolduc estimate of savings is \$1,375 millions.

**OMB Assessment.** This appears to be a new savings estimate for PPSSCC issue number OSD 15 and for which the PPSSCC report claimed no dollar savings. We also believe no savings would result from implementation of this item.

**Item (3).** Centralize the acquisition of "common use" items through the GSA. The Bolduc estimate of savings is \$312 million.

**OMB Assessment.** This appears to be a savings estimate for PPSSCC issue number PROC 20. The \$312 million in estimated savings identified by the Commission is based "primarily on range estimates obtained from GSA." Of the \$312 million, the Commission estimates that 50 percent would come from FSS; 25 percent from ADTS; and 25 percent from PBS. No further explanation was given except that the Commission believed GSA should acquire more than its present \$2.9 billion share of the \$9 billion now spent by the civil agencies for "common use items." The estimate appears to be a cost avoidance rather than budget savings, and there is no OMB estimate of the budget savings that would accrue through further centralization.

**Item (4).** Lessen the impact of socio-economic programs on the acquisition process. The Bolduc estimate of savings is \$12,497 million.

**OMB Assessment.** This appears to be a new savings estimate for PPSSCC issue numbers PROC 2A and 2B. The PPSSCC report on these items identified a total of \$847 million in savings. (\$635 million for PROC 2A and \$212 million for PROC 2B.)

PROC 2B was adopted in the 1985 budget, i.e., \$212 million has already been saved and reflected in the current services base. The rest must be for PROC 2A which assumes that a study to promptly eliminate major socio-economic programs will result in eliminating these programs. This will require the enactment of legislation.

**Item (5).** Encourage implementation of OMB Circular A-76 on contracting-out. The Bolduc estimate of savings is \$7,390 million.

**OMB Assessment.** This appears to be the net savings estimate for PPSSCC issue numbers PROC 18, OSD 7, and EX 1. The 1986 budget reflects \$1,099 million in new three-year savings and cost avoidances, as follows:

| <u>A-76 Program</u>                         | <u>1986</u> | <u>1987</u> | <u>1988</u> | <u>Total</u> |
|---------------------------------------------|-------------|-------------|-------------|--------------|
| Nondefense Agencies:                        |             |             |             |              |
| New cost savings in 1986 budget             | \$ 60.4     | 166.3       | 262.7       | 489.4        |
| Defense Agencies:                           |             |             |             |              |
| Our estimate of A-76 cost avoidances in DoD | \$109.7     | 195.0       | 304.7       | 609.4        |

The PPSSCC assumed a savings rate from contracting-out of 33% from the cost of in-house performance while we estimate 20% for budgetary purposes. In addition, the PPSSCC assumed that 500,000 full-time equivalent positions would be cost-studied over five years while we estimate that agencies will study 200,000 positions during that period. Legislative restrictions on the application of A-76 in several agencies (DoD, GSA, VA and Interior) further limit the realization of savings through A-76 cost studies and result in lower estimates.

**Item (6).** Simplify the regulatory requirements. The Bolduc estimate of savings is \$644 million.

**OMB Assessment.** This appears to be a new savings estimate for PPSSCC issue number OSD 17 for which the PPSSCC report, with which we agree, claimed no savings.

**Item (7).** Enhance competition in contracting through the use of functional or performance specifications. The Bolduc estimate of savings is \$7,423 million.

**OMB Assessment.** This appears to be a savings estimate for PPSSCC issue numbers PROC 22, for which the PPSSCC report estimated \$131 million in savings, and OSD 20, for which the PPSSCC estimated \$7,329.7 million in savings. First, OSD 20, was adopted in the 1985 budget and the amount cannot be saved again. As for PROC 22, the \$131 million estimate is based on the assumption that at least one-half (1,500) of the existing civil agency detailed specifications can be converted to simplified commercial item descriptions and that the simplified descriptions will result in a 5 percent to a 7-1/2 percent procurement savings. OMB agrees that simplifying specifications will result in cost savings to the

Government. A previous GAO study undertaken within GSA indicated that savings within a 2 to 7 percent range were realistic. These savings, however, are in the nature of cost avoidances and are not necessarily available for other uses. Even greater cost avoidances could be achieved if an aggressive specification simplification and commercial item acquisition program could be initiated within the Department of Defense. This, however, would require the removal of language contained in the last two Defense Appropriation Acts that prohibits DoD from using "commercial item acceptability criteria" in their procurement solicitations.

**Item (8).** Improve cost estimates, scheduling, and risk management techniques. The Bolduc estimate of savings is \$18,348 million.

**OMB Assessment.** This appears to be a new savings estimate for PPSSCC issue numbers OSD 22 and PROC 8. The PPSSCC report claimed no savings for OSD 22 and \$2,940 million for PROC 8. Also, OSD 22 and PROC 8 were adopted in the 1985 and prior budgets. Therefore, the \$2,940 million is already in the current services base. The PPSSCC estimated that a percentage of the annual spending on weapons systems could be saved each year through better cost estimating procedures. While we agree that more accurate cost estimates would be beneficial and have had some success in improving the accuracy of cost estimates in recent years, the effects of improvement on total costs are hard to predict. We suspect the variance between the two different PPSSCC estimates reflects this difficulty.

**Item (9).** Increase stability in the acquisition process through greater use of multi-year contracting. The Bolduc estimate of savings is \$3,415 million.

**OMB Assessment.** This appears to be a restatement of the savings estimated for PPSSCC issue number PROC 4 "Multi-year Contracting." In the PPSSCC report the \$3,415 million savings estimate was based on multi-year contracting for major weapon systems and selected application of multi-year contracting for other procurements in both DoD and civilian agencies. Savings from multi-year contracting have been realized in DoD procurements as reflected in FY 85 and prior budgets. These savings, which exceed the PPSSCC level, are included in the current services base for 1986. Additional savings may be possible if Congress enacts the OMB proposed legislation to extend multi-year contracting authority to civilian agencies.

**Item (10).** Improve program management by strengthening the role, responsibility, authority, and accountability of the program manager. The Bolduc estimate of savings is \$1,285 million.

**OMB Assessment.** This appears to be a new savings estimate for PPSSCC issue number PROC 9 for which the PPSSCC report estimated savings of \$980 million. PROC 9 was adopted in the 1985 and prior budgets, and the \$980 million is already reflected in the current services base. As in the acquisition and weapon system areas, savings for improving program management in Defense are highly judgmental.



**QUESTIONS OF SENATORS COHEN AND LEVIN****Question No. 2**

The proposed merger of the Office of Federal Procurement Policy into the management side of OMB is, as you know, of paramount interest to the Oversight Subcommittee. To facilitate the Subcommittee's consideration of this merger proposal, would you provide for the record the Administration's legislative proposal necessary to accomplish the merger, as well as the OMB's specific plans for how this merger would be implemented?

Answer. Because it is still in development, we are unable, at this time, to provide the Administration's proposal for merging the OFPP with OMB. We will do so, however, as soon as a coordinated executive branch proposal is finalized.

Similarly, specific plans for effecting the merger are being developed and are not yet available. Essentially, however, we are proposing that the Office, in its entirety, would become an integral element of the OMB management structure. The principal functions, authorities, and responsibilities of the Administrator would remain in effect, but be assigned to the Director of OMB. Because of the organizational integration of the procurement policy function within OMB, a separate appropriation would no longer be required. Once approved by the Congress, we believe that the merger could be accomplished very quickly and very simply, with virtually no interruption in the conduct of the procurement policy function, since no physical relocations or personnel changes are contemplated.

## QUESTIONS OF SENATORS COHEN AND LEVIN

Question No. 3

You testified that the proposed merger will "make the (OFPP) more effective, give it greater stature, and integrate it more thoroughly into the OMB budget and management processes."

**A.** How would this merger enhance the OFPP's effectiveness and stature?

**Answer.** We are convinced that the effectiveness and stature of the Office can be enhanced by making it a fully integrated element of OMB - with all the authority and visibility that identification provides. To some degree, the OFPP has operated as a semi-independent entity up to this point - not making full use of the OMB budget and management processes to further its goals of reforming the Federal procurement process. While it has been more effective in recent years, that effectiveness can be increased under our proposed merger.

**B.** Why is the organizational integration of OFPP into OMB necessary to accomplish the policy integration recommended by the Grace Commission?

**Answer.** Procurement is an important management tool but it does not exist in a vacuum. It is an integral part of the Federal management process - affecting, and being affected by, personnel policies, budget and accounting programs, supply management procedures, and a host of other interrelated management functions used by Government to conduct its business. By integrating the procurement policy function, organizationally, into the full management program of OMB, we are assuring that the policy integration advocated by the Grace Commission is achieved. Without such a merger, policy integration is often a "hit-or-miss" proposition - as a separate OFPP and separate OMB respond to priorities and agendas which are constantly changing and not easily coordinated unless organizationally integrated.

**C.** The Commission on Government Procurement listed "responsiveness to Congress" as one of the OFPP's major attributes. Will integrating the OFPP more thoroughly into OMB necessarily limit the Office's responsiveness to Congress?

**Answer.** We don't anticipate any change in OFPP's responsiveness to the Congress under our proposed organizational integration. Certainly, there will be no diminution in responsiveness. It is important to realize that the function will continue to have a statutory base, including existing statutory provisions designed to enhance responsiveness. For example, we do not propose to eliminate the requirement that OFPP keep the Congress fully advised of its activities by (1) providing an opportunity for Congress to review OFPP policy directives and regulations prior to issuance, and (2) by reporting annually to Congress on its major activities. We would expect, moreover, that the Office, from time-to-time, would continue to conduct studies of procurement issues for the Congress, as it has done in the past.

## QUESTIONS OF SENATORS COHEN AND LEVIN

Question No. 4

If, as you testified, the procurement "division" of OMB no longer would warrant a separate Senate-confirmed administrator, doesn't this imply the procurement management is being downgraded?

Answer. We do not believe such an implication is warranted. The position of Administrator would be retained. In effect, under our proposal, the procurement policy functions of the OFPP will be subsumed into the mainstream of OMB management initiatives. This will permit the exercise of OMB's full force and authority in achieving the Administration's procurement reform program, specifically, and the enhancement of the procurement policy function, generally. The best analogy to the proposed relationship of OFPP to OMB is that between the Office of Information and Regulatory Affairs and OMB. Moreover, we believe that the institutional authority of OMB - and not the presence of a Presidentially-appointed/Senate-confirmed Administrator - is the more crucial factor in maintaining and enhancing the stature and effectiveness of the procurement policy function.

## QUESTIONS OF SENATORS COHEN AND LEVIN

Question No. 5

Unless Congress approves the merger proposal, the law still requires a Presidentially-appointed Administrator.

A. When does the Administration expect to submit a nomination for this post?

Answer. We are screening applicants for the position of Administrator of OFPP. In the interim, a careerist with extensive experience in Federal procurement has been appointed Acting Administrator and is aggressively pursuing a broad range of needed procurement reforms and policies. At the same time, we anticipate that the Congress will examine and act on the Administration's legislative proposal to strengthen the OFPP and integrate its activities and functions in the OMB structure.

B. Do you also plan to fill the SES position for Associate Administrator for Policy, which has been vacant since last November?

Answer. We do not plan to fill the position on a permanent basis at this time. We will be looking at the grade structure of OFPP in the course of developing plans for its merger into OMB. It appears, however, that in view of the small number of total positions assigned to the Office and the relatively large number of Senior Executive Service positions currently on the OFPP roster, some adjustments may be necessary and this position could be used for this purpose.

## QUESTIONS OF SENATORS COHEN AND LEVIN

Question No. 6

Short of merging the OFPP into OMB, what other steps can be taken to enhance the Office's effectiveness and stature? Would you reconsider your position on restoring the OFPP's full regulatory authority which, as you previously testified, the Administration opposed on the basis that the Office had sufficient authority to operate effectively?

**Answer.** With the additional regulatory authority conveyed by Public Law 98-191, OFPP now has ample regulatory authority to perform its statutory functions. However, we may wish to clarify and reinforce this in a future amendment to the OFPP Act. Although there has been little occasion to exercise this new authority up until now, we anticipate that such use may be required in the future. That authority, in addition to the Paperwork Reduction Act (P.L. 96-511) authority and regulatory review authority (E.O. 12291 and E.O. 12498) provided to our Office of Information and Regulatory Affairs should enable OMB to assure that the Federal Acquisition Regulation system, for example, is maintained in the manner which the Congress and the Administration intended.

With regard to the broader question, we have concluded that few, if any, steps, short of a merger, are likely to enhance, substantially, the stature and effectiveness of the Office. We are convinced that meaningful improvements in the functioning of the Office are contingent upon its full integration into the OMB organizational structure.

## QUESTIONS OF SENATORS COHEN AND LEVIN

Question No. 7

The Grace Commission recommends that the thresholds for socio-economic programs should be uniform and tied to the \$25,000 small purchase procedure threshold to lessen their impact on the acquisition process. As a step in that direction, you stated in your testimony that the OFPP is proposing a test to exempt small purchases from socio-economic programs at selected procurement activities.

A. Would you provide a copy of the OFPP's test proposal for the record?

Answer. A copy of the test plan proposed by GSA, DoD, and NASA is attached. OFPP's proposal may differ from this plan.

B. What do you hope to accomplish through this test?

Answer. We hope to demonstrate that exempting small purchases from socio-economic programs will produce significant savings without adversely affecting the programs or their intended beneficiaries.

C. What criteria would be used for determining the success of the test?

Answer. Five criteria will be used to determine the success of the test:

1. Reduction in procurement costs.
2. Alleviation of paperwork burden on Government and industry.
3. Reduction in procurement leadtime.
4. Increase in small business participation.
5. Providing efficient and inexpensive procurements without adversely affecting beneficiaries of other statutory provisions.

## INNOVATIVE PROCUREMENT METHODS

I. Title: Test Simplified Procurement Practices for Small Purchases.

II. Statement of Need and Objectives: Ensure that the Government has a fast, easy to understand, and inexpensive procedure for low dollar purchases, by eliminating numerous unnecessary provisions from small purchases and returning this category of procurement to the level of efficiency originally intended.

When the Armed Services Procurement Act of 1947 and the Federal Property and Administrative Services Act of 1949 (Acts) were enacted, they provided for the use of small purchase procedures for purchases up to \$1,000. These small purchase procedures were authorized to provide for the efficient and inexpensive procurement of relatively small dollar value items and services. Over the years, the Acts have been amended to raise the small purchase threshold, first to \$2,500, then to \$10,000, and in 1981 and 1983, to the current threshold of \$25,000. The adjustments to the threshold reflected Congress' recognition of the impact of inflation on what constitutes a low dollar value purchase.

Over the years, Congress also enacted a variety of legislation, generally outside of the major procurement statutes, which nonetheless have imposed significant requirements on the contracting process. At the time of their enactment, Congress usually recognized the need to balance the benefits of the legislation (often unrelated to the commercial transaction) with the potential adverse impact of its requirements on the economy and efficiency of the procurement process. As a result, the statutes were frequently drafted so as to have little or no application to small purchases. This was accomplished by setting the "floor," in terms of contract dollar value, for the statute's applicability at the existing statutory "ceiling" for use of the small purchase authority.

Unfortunately, although the "ceiling" for small purchasing has been regularly adjusted to take into account the declining purchasing power of the dollar, the "floors" for applying other statutory requirements have not always kept pace. As a result, and contrary to the original intent of Congress, the requirements of these statutes have become applicable to many small purchases. Thus, procedures originally intended to ensure the expeditious and economic acquisition of low dollar value items and services are now subject to a wide array of relatively complex and costly administrative steps, solicitation provisions, and contract clauses. The resultant burdens are felt not only by the Government, but also by the private sector, particularly small businesses.

The rationale for the test is to verify the hypothesis that the use of unencumbered, simplified small purchase procedures could accomplish the following:

1. Reduce procurement costs.
2. Alleviate paperwork burdens on Government and industry vendors.
3. Reduce procurement leadtime.



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4. Increase small business participation.
5. Provide for efficient and inexpensive procurements without adversely affecting beneficiaries of other statutory provisions.

III. Proposed innovative procurement method. All statutory and regulatory provisions currently applicable to small purchases which are impeding the efficient and inexpensive procurement of small dollar value (under \$25,000) items and services will be eliminated. For test purposes, all purchases under \$25,000 will be reserved for small business under small business - small purchase set-asides unless the contracting officer determines that he/she cannot reasonably expect to obtain two or more offers from small business concerns that will be competitive in terms of market price, quality, and delivery.

IV. Applicable policy objectives from P.L. 98-191. The proposed innovative procurement methods are consistent with the following policies contained in the Office of Federal Procurement Policy Act:

1. Promoting full and open competition;
2. Establishing policies, procedures, and practices which will provide the Government with property and services of the requisite quality, within the time needed, at the lowest reasonable cost;
3. Promoting the development of simplified uniform procurement processes;
4. Promoting the participation of small business concerns;
5. Supporting the continuing development of a competent, professional work force;
6. Eliminating fraud and waste in the procurement process;
7. Eliminating redundant administrative requirements placed on contractor and Federal procurement officials;
8. Promoting fair dealings and equitable relationships with the private sector;
9. Ensuring that payment is made in a timely manner and only for value received;
10. Requiring, to the extent practicable, the use of commercial products to meet the Government's needs;

V. Criteria for determining the success of the test program.

A. Reduce procurement costs. We will compare prices paid for the same or similar items or services procured using the existing small purchase procedures with purchases made using the test procedures. The test will be considered successful if the test procedures consistently produce significantly lower prices.

B. Alleviate paperwork burdens on Government and industry. We will compare the paperwork burden placed on the Government and industry under the current procedure vs the test procedure. Success will constitute (1) a reduction in burden without a detrimental effect on the quality of the item or service and (2) an increase in the number of vendors who are interested in competing for contracts.

C. Reduce procurement leadtime. We will compare the procurement leadtime for the same or similar items or services procured using the existing small purchase procedures with purchases made using the test procedures. The test will be considered successful if the test procedures consistently produce significantly shorter procurement leadtimes.

D. Increase small business participation. We will compare the number of small businesses who are interested in competing for work under the current procedures vs the test procedures. The test will be successful if more small businesses are found to be competing for work under the test procedures.

E. Provide efficient and inexpensive procurements without adversely affecting beneficiaries of other statutory provisions. The effects of the test procedures on the beneficiaries of other statutes, will be examined, whenever measurable, and the test will be successful if there is no adverse impact on the intended beneficiaries, inconsistent with the statutory objectives.

#### VI. Measurement Plan and Schedule.

A. Overall Plan and Schedule. The General Services Administration (GSA), the Department of Defense (DOD) and the National Aeronautics and Space Administration (NASA) will coordinate the conduct of the test. It is anticipated that the test authority would be available for up to a 2-year period. A coordinating group composed of representatives of the two agencies shall devise procedures to ensure the validity of the test results. Separate test steering groups, within GSA, DOD and NASA shall develop test training plans and ensure that participating offices selected as test sites are properly prepared. The performance of the test activities will be monitored by the agency steering groups. Continued coordination between GSA, DOD and NASA will take place during the test period.

The Federal Acquisition Institute (FAI) will assist in developing questionnaires to determine test results and in performing analyses to determine test validity.

B. Items to be Measured. Items to be measured shall consist of relatively standard commercial items and services which are easily measurable and for which decentralized purchasing is feasible. Examples: (1) painting cost/sq. ft., (2) cleaning cost/sq. ft., and (3) standardized commercial supplies (plumbing, electrical, office supplies, etc.). Standard quality control procedures and reporting would be used to determine that the item or service acquired under the test procedures was similar to the items received in the past or by the control group.

1. Reduction in Prices. We will determine reduction in prices by comparing prices paid by the test group with:

a. Historical prices paid for items or services in like or similar quantities during the past year(s) after adjustment for inflation.

b. Prices for the same or similar items/services by other procurement offices using current procedures (the control groups).

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2. Alleviate paperwork burden.

a. In previous submittals to OMB related to the Paperwork Reduction Act, we have established standard burden hours for many of the reporting procedures resulting from the Public Laws cited in Section VII, Applicable Statutes. We will use this formula to calculate the savings to the public and the Government by eliminating the reporting requirement of these statutes.

b. We will also use the items to be measured in item #B above (i.e. painting cost/sq. ft.) and calculate any change in the numbers of bidders between the test group and (1) historical records of bidders for the items or services in like or similar quantities during the past year(s) and (2) the control group.

3. Reduce procurement leadtime.

a. Measure the time from receipt of the requirement by the procuring official to the date of award.

b. Measure the response time from issuance of the request for quotations/proposals to the date for submission of quotations/proposal.

c. Paperwork burden placed on the commercial organization and its contractors in obtaining supplies or services in like or similar quantities to the test group.

4. Increase small business participation. The extent of any increased small business participation in the procurement process will be evaluated by comparing small business participation between (1) the test group and historical data and (2) the test group and the control group.

VII. Applicable statutes, regulations, or procedures to be waived or changed.

Legislation would be required to raise the threshold for application of statutes, Executive Orders, and administrative regulations to \$25,000 to coincide with the dollar ceiling established for small purchase procedures. The legislation would, in effect, state that: Notwithstanding any other provision of law, simplified procedures may be established to economically and efficiently make small purchases.

Existing statutory requirements for which waiver is requested:

1. Service Contract Act (41 U.S.C. 351(a).
2. Davis-Bacon Act (40 U.S.C. 276(a).
3. Small Business Act (15 U.S.C. 637(d)(2)(A) and (e)(1)(A).
4. Walsh-Healey Act (41 U.S.C. 35).

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5. Contract Work Hours and Safety Standards Act (40 U.S.C. 327-333).
6. Rehabilitation Act of 1973 (29 U.S.C. 793(a)).
7. Vietnam Era Veteran's Readjustment Assistance Act (38 U.S.C. 2012(a)).
8. OFPP Act, as amended (41 U.S.C. 418(a)(1)(A)).

Other requirements for which waiver is requested:

1. Equal Employment Opportunity provisions.
2. Reporting requirements of OMB Circular A-40.

VII. Scope of test.

We plan to conduct the test procedures in selected DOD, GSA and NASA field offices which procure supplies, services and construction.

Offices selected will procure a variety of items which are similar so comparisons can be easily made. Also purchases are expected to be of a repetitive nature so past purchases in the same office as well as purchases being made at the same time in other offices can be compared.

A group of offices would be identified as a control group and another group identified as the test group. DOD, GSA and NASA will establish the number of purchases that need to be reviewed to provide a valid sampling of the test results.

## QUESTIONS OF SENATORS COHEN AND LEVIN

Question No. 8

You pointed out in your testimony that the Federal Acquisition Regulation represents a substantial reduction in the thousands of pages of procurement regulations. While this may be true, many experts are nonetheless concerned that the proliferation of agency supplements to the FAR, which total nearly twice the pages of the FAR itself, will lead us back to where we started. How can we ensure that, with time, the FAR system will improve, rather than get worse?

Answer. We believe that one of the best ways to ensure that the FAR System will improve, rather than get worse, is to monitor agency implementation. Agency implementing and supplementing regulations will, of necessity, continue to exist if required to implement the FAR System within the agency or to satisfy specific and unique agency needs, such as certain designations and delegations of authority, work-flow procedures, and internal reporting requirements. As agency supplements are subjected to closer OMB/OFPP and public scrutiny and comment, and as everyone comes to a better understanding of the FAR System, it is reasonable to expect that agencies will become more conscientious about bringing the supplements into compliance with the requirements of the FAR and the FAR System. Evidence of this is already becoming visible. We believe that regulatory review will be effective in assuring that the FAR system concept is implemented.

## QUESTIONS OF SENATORS COHEN AND LEVIN

Question No. 9

You stated that the OFPP is responsible for reviewing agency supplements to ensure against inconsistent, as well as unnecessary, supplementation.

**A.** What has OFPP done to date to fulfill this responsibility?

**Answer.** (1) During the Spring of 1984, OFPP reviewed and compared selected sections of six agency acquisition regulations implementing and supplementing the FAR. OFPP also reviewed selected sections of the FAR and all of the Federal Acquisition Circulars (FAC's). These reviews revealed some of the general problems that were surfacing in the FAR System. Therefore, during the summer of 1984, OFPP informed all Agency Senior Procurement Executives, the two FAR Councils, and the FAR Secretariat of the problems, and pointed out some of the consequences of not striving to identify and solve problems as they emerge, and encourage guarding against them in the future. Agencies were also reminded of the FAR requirement for formal procedures for each agency to review its regulations. Agencies are working with us to accomplish this function.

(2) OFPP continues to work with the two FAR Councils to eliminate examples of conflicts, inconsistencies, redundancies, and items needing correction or clarification in the FAR.

(3) Since July 1984, OFPP has been working with the FAR Councils to assure that action is taken to implement specific OFPP policy letter requirements in the FAR by March 31, 1985.

(4) OFPP is revising the OFPP Policy Letter on the FAR System. One of the revisions will define the FAR System. The Policy Letter will remind the agencies of OFPP's new authority under Public Law 98-191 to actively oversee the FAR system, and include procedures implementing OFPP authority to prescribe regulations when DoD, GSA and NASA are unable to agree on, or fail to issue regulations in a timely fashion.

(5) As the result of OMB Bulletin No. 85-7, dated December 14, 1984, OFPP is reviewing any agency regulation and associated procedures (as defined in the Bulletin) implementing or supplementing FAR Subparts 15.6 and 32.5 or pertaining to the subjects of source selection or progress payments based on costs. It is also reviewing agency-wide regulations implementing the Competition in Contracting Act, including those regulations discussed in the GAO report forwarded by Senators Cohen and Levin and Congressmen Brooks and Horton. Regulations which are not essential or required to satisfy unique agency needs, such as coverage that merely repeats, paraphrases, or restates the FAR or higher-level agency acquisition regulations are being identified for elimination.

**B.** While we believe that OFPP should play a central role in reviewing agency supplements, can the office adequately assume this labor-intensive responsibility given its limited resources?

**Answer.** As you have stated, this is a labor-intensive effort. Identification of duplicative requirements in and between agency supplements, and the control of proliferation are time-consuming tasks, given OFPP's limited resources.

But, in addition to the benefits mentioned in A(5), the current OMB/OFPP role is viewed by many in the private sector and in the Government as motivating some agencies to attempt to gather and identify all existing lower-tier regulations and procedures. We view all of these efforts as being essential to the goal of ensuring that the FAR System works as it was intended and that its integrity is maintained. We plan to continue to devote a reasonable amount of effort in this direction. However, as this initial review process and the resultant "weeding out" of extraneous regulations progress, we believe that the agencies will assume more responsibility in these areas, and that OFPP's role will not be as time-consuming as it is now.

C. Can we entrust the agencies to "police" their own regulations?

Answer. It would probably be unfair to answer "yes" or "no," given the varying degrees of "dedication" to the task by the various agencies. We do believe that they should be given a chance to prove that they are up to the task and that they will do it. Congressional interest is a prime motivational factor in this regard. Public opinion and comment is another. Just a year ago there were no agency FAR supplements. Agencies were unfamiliar with the new FAR System. They were under severe time constraints in preparing their supplements. Now that the System is in place and an adequate amount of time has been allowed for training, familiarization, and transition, it is appropriate and timely to expect agencies to get on with "policing" and to assign it a high priority. However, OFPP has the authority, which it will be in a stronger position to exercise if it is merged into OMB in accordance with our proposal, to step in if self-policing proves inadequate.



## QUESTIONS OF SENATORS COHEN AND LEVIN

Question No. 10

The Grace Commission recommends that acquisition of "common use" items, such as office equipment and supplies, should be centralized in the General Services Administration. The problem, as we discussed during the hearing, is that agencies frequently ignore GSA and buy their common-use items "off schedule." You agreed that agencies should be required to buy through GSA, when designated as the required source of supply, unless they have a compelling reason for not doing so.

**A.** Are existing regulations adequate to establish GSA as a mandatory source of supply, and do they provide adequate controls for determining whether compelling reasons to buy "off schedule" exist?

**Answer.** The regulations, as specified in Federal Acquisition Regulation (FAR) subsection 8.404-1, are adequate. The regulations are clear and provide appropriate exceptions, which allow mandatory users of the Federal Supply Schedules to "buy off-schedule." These exceptions are:

- a. Urgent requirements; i.e., when an ordering office requires supplies or services with a shorter delivery time than specified in the schedules;
- b. Small requirements; i.e., dollar or quantity minimums below which ordering offices are not obligated to order and contractors are not obligated to accept orders;
- c. Maximum order limitations; i.e., dollar amounts or quantities which are specified in the schedules and above which agencies shall not submit orders and contractors shall not accept orders;
- d. Geographic coverage; i.e., when users are located outside the geographic area covered by the schedule;
- e. Lower prices for identical items; i.e., when an ordering office finds an identical product available from another source at a lower price; and
- f. Absence of follow-on award; i.e., when a schedule has expired and has not been renewed or extended.

**D.** What is OMB doing to ensure agencies are making maximum use of GSA? Are there penalties for not complying with GSA regulations or instructions?

**Answer.** Over the years, OMB has worked with GSA to help improve both the quantity and quality of its services. Such programs as market research and analysis, commercial item descriptions, specifications simplification, and improvements to the multiple award schedules were, in part, initiated by OMB, in partnership with GSA. In the main, agency reliance on GSA depends on the efficient, effective and economical delivery of services by GSA and not on reliance

"required by regulations." The penalties for not complying with the GSA regulations are primarily administrative. Inspectors General and General Accounting Office reviews frequently help identify areas of non-compliance with regulations. Explanations regarding the non-compliance, when discovered by such reviews, is often required by both the agency head and appropriate Congressional oversight committees.

C. Is additional legislation necessary to clarify and/or augment GSA's authority with respect to procurement and supply management?

Answer. Additional legislation is not considered necessary to clarify or augment GSA's authority. Titles 2 and 3 of the Federal Property and Administrative Services Act of 1949, as amended (40 U.S.C. 471) are direct and specific with regard to GSA's procurement and supply management responsibilities and authorities.

## QUESTIONS OF SENATOR RUDMAN

Question No. 1

Why is OMB now willing to potentially increase the role of Government by permitting Government agencies to compete with the private sector for work being contracted out by other Government agencies? I would appreciate a detailed justification of the benefits to the taxpayers involved in this policy shift, including copies of any studies done by OMB or other agencies on this subject.

**Answer.** OMB, in its recent changes to OMB Circular A-76, is not wavering in its support of the Circular and its commitment to the policy of reliance on the private sector.

There is no change in the policy of using the private sector for all new commercial activity requirements. There is no change in the policy of continuing under contract those functions that are currently under contract. The only time a competition with the Government is allowed in these cases is when contract prices are unreasonable or performance is unsatisfactory. For the Government to establish a new in-house operation, the Government cost must be less than contract costs by 10 percent of Government personnel related costs, plus 25 percent of the acquisition cost of any additional capital assets not currently owned by the Government.

There is no change in the basic A-76 policy of competing Government operated commercial activities with the private sector. This concept of competition where Government employees are involved was fully integrated in the 1979 revision to the Circular. The concept had evolved in earlier Circulars, but a formal cost based decision process was not included until 1979. This portion of the A-76 policy where Government employees are involved has had a very sluggish track record. Our recent instructions to agencies are designed to accelerate and strengthen implementation of this part of the A-76 policy.

In the last five years less than 50,000 Government held commercial activity positions have been cost compared. Over 43,000 of these were in the Department of Defense. Only 6,000 positions were reviewed in the civilian departments and agencies. The total number of positions identified by the agencies for actual study before our recent changes was about 120,000. With a civilian work force of over 2 million, A-76 was not a big program.

Resistance to implementation of A-76 has emanated from several quarters. Resistance has come from Federal employees who frequently consider their job protection paramount, and from agency managers who perceive A-76 as a threat to their turf. Congress has also erected roadblocks to implementation. In its last session it passed legislation prohibiting or hindering cost comparisons in several agencies, including Interior, Transportation, and Health and Human Services, etc. For example, the Defense Department has been forbidden by Congress to contract for security guards and firefighters, even where they are readily available from competent local municipalities or contractors. Other legislation proposed would

have pre-empted agencies from making cost comparisons on such routine services as snow removal, vehicle maintenance, and trash disposal. There is a natural reluctance on the part of most people to contract out the commercial activity functions performed by Government employees without at least giving them a chance to prove their cost effectiveness.

The recent redefinition of A-76 was designed to ameliorate and balance the concerns of these elements and to allow the Executive Branch to move forward in reinvigorating the policy and developing it as an effective productivity tool. For several reasons, we believe the revised instructions will aid our efforts next year to build support within these three groups -- Congress, Federal managers, and Federal employees -- and enable us to proceed toward successful fulfillment of A-76's potential.

The recent changes are expected to increase both the quantity and quality of the competition. In fiscal year 1985, we project that agencies will review more than double the number of positions reviewed in 1983 with increases in the program size in future years. This increase in the number of opportunities for the private sector to compete will result in more private sector operation of commercial activities.

The 14 general categories initially selected for Government-wide emphasis contain over 320,000 positions, the majority of which will be competed with the private sector in the next several years under the terms of the September 27 revisions.

Agencies are by no means restricted to the 14 general categories. Not only can they continue current review programs outside the 14 categories, but they may also add other activities that show a significant potential for savings. When productivity reviews have been completed on the 14 categories, other common tasks will be added and considered for cost comparisons.

Concentrating efforts Government-wide on the 14 initial categories will alleviate two past weaknesses: diffusion of the A-76 effort over too broad a scope to be effective, and unwise selection of tasks for study. It will also allow development of a performance based management system and a viable productivity measurement system for a broad gamut of Federal activities.

OMB is more closely monitoring the Departments and agency implementation plans to ensure the program goals are achieved. Savings resulting from projected studies are being reflected in the budget so that they can contribute to reducing the deficit. In addition, we have established a Productivity Clearinghouse to promote information sharing within Government and with the private sector to improve the quality of the studies.

Our revised policies do not increase the role of Government - but do encourage competition between the Government and the private sector where activities are currently performed by Government employees. This competition between the Government and the private sector results in the lowest overall cost for the taxpayers. In DoD's recent report on "How Winners Win" (attached) there is a chart which shows that in-house bids average 15 percent below the original cost of an activity, contractor bids reduce costs an average of 24 percent, but the winning bids average 27 percent below original cost. DoD has recently reported that winning bids now average 29 percent below original cost. The Government "wins" the competition about 50 percent of the time. Without the Government competition the taxpayer would not have the additional five percentage points in savings.

## QUESTIONS OF SENATOR RUDMAN

Question No. 2

When making recent revisions to OMB Circular A-76, why was the 10 percent penalty on the bids of private companies retained?

Answer: The 10 percent of Government personnel-related costs differential that is applied to contract bids was retained to give consideration to real but intangible costs that are incurred when a conversion is made. These costs include loss of production, the temporary decrease in efficiency and effectiveness, the cost of retained pay and temporary operations of facilities at reduced capacity. Because this estimated cost is only a percentage of personnel related costs, it is less than 10 percent of the full cost. However, there are other more tangible costs of converting to contract that are also added to the contractors bids. When these other costs are added to the conversion differential, the total is at least a full 10 percent cost advantage for the Government. These costs include (1) contract administration costs, and (2) severance pay and relocation and retraining costs. These costs are added not as a penalty but to closely determine the true cost to the Government of converting to contract.

When the Government believes the costs of contracts are unreasonable or performance is unsatisfactory and A-76 authorizes a cost comparison, the 10 percent of personnel cost factor is also applied to the Government's bid price. For the Government to retain an operation in-house, its costs must be less than contract costs by the 10 percent of Government personnel costs, plus 25 percent of the cost of acquiring any new capital assets.

We believe these cost differentials are necessary to protect the taxpayer from unwarranted conversions.

HOW WINNERS WIN  
LESSONS LEARNED FROM CONTRACT  
COMPETITIONS IN BASE OPERATIONS SUPPORT

September 1984

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## Executive Summary

## HOW WINNERS WIN

LESSONS LEARNED FROM CONTRACT COMPETITIONS  
IN BASE OPERATIONS SUPPORT

Competition in Base Operations Support (BOS) produces savings for the Department of Defense. In the face of competition, costs drop by an average of 27 percent whether a contractor or the in-house work force wins. If we knew how winners realized those savings, they could perhaps be duplicated by in-house Government activities even when competition isn't possible.

Winners of competed BOS functions follow many common approaches to increase their productivity. For family housing maintenance and audiovisual services, these approaches include:

- organizational changes, simplifying organizations to reduce the number of supervisors;
- consolidation of working locations to eliminate the expense of supervising dispersed activities;
- use of working supervisors who not only direct and schedule workers but also perform direct labor themselves;
- use of multiskilled workers to reduce periodic backlogs with a smaller work force;
- use of lower-skilled workers, reserving higher skilled employees for jobs that suit their talents;
- provision of equipment, vehicles, and communications to maximize worker productivity;
- establishment of worker goals and accountability to motivate employees;
- provision of computer support to complete work more quickly and accurately;
- elimination of unnecessary work, abolishing or modifying nonessential tasks.



These approaches appear to be unique to activities that have undergone competition, and we observed them in most of the 14 winning activities we visited. Contractor winners are even more frugal than in-house winners; they rely heavily on overtime, part-time labor, simplified supply procedures, and responsive vehicle and equipment maintenance to further improve productivity. They also tend to pay lower wages to BOS workers than does DoD, and they are quicker to hire and fire employees.

Activities whose functions have not been competed or are exempt from competition could use many of the approaches we observed. We recommend that OSD:

- establish a clear goal of winning Commercial Activities (CA) competitions with its in-house work force and encourage broad application of the CA program to as many BOS activities as possible;
- disseminate the ideas we observed through the Efficiency Review Program;
- make our findings available to installation commanders participating in DoD's Model Installations Program.

We further recommend that the Military Services:

- examine contractor-specific approaches for their applicability to all in-house activities;
- provide in-house winners with as much budget stability as possible;
- ensure, through a formal arrangement, that equipment and vehicle resources will be available to an in-house work force before declaring it a competition winner.

Competition is the incentive that produced the changes we observed. It will be more difficult to produce savings without the pressure of competition, but through wide dissemination of lessons learned, a sizable increase in BOS productivity is possible.

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## 1. STUDY BACKGROUND AND RECOMMENDATIONS

BACKGROUND

For many years, the Department of Defense (DoD) has engaged both in-house employees and private contractors to provide Base Operations Support (BOS) services at military installations. BOS includes such activities as family housing, real property maintenance, civilian personnel administration, vehicle maintenance, food service, supply, contracting, security and law enforcement, and others; in short, the support services necessary to accomplish the installations' missions. Until 1979, in-house activities could expect a long-term existence in relative security, but after the Office of Management and Budget revised its Circular A-76 in that year, the Military Services were required to make periodic reviews to determine whether in-house activities could be accomplished more economically by contract.<sup>1</sup> If a contractor's cost resulted in savings of at least ten percent of the in-house personnel costs, the activity was to be contracted. This revolutionary change in the way the Government did business introduced competition for the first time to many in-house activities that had never felt any externally applied pressure to be cost-efficient.

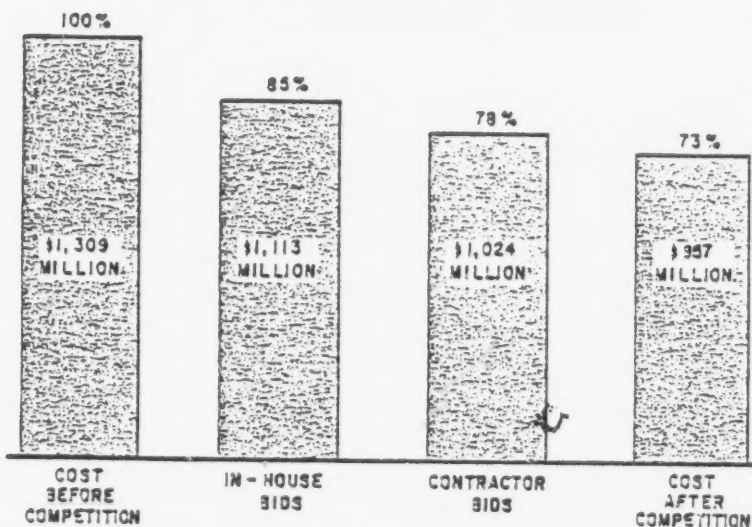
In DoD, commercial activities (CA) cost comparisons in the BOS area show that substantial savings result whether the in-house activity or a private contractor wins the competition. Between February 1979 and December 1983, 921 BOS competitions had taken place affecting approximately 24,000 jobs. As shown in Figure 1-1, the cumulative annual operating cost for the competed

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<sup>1</sup>U.S. Office of Management and Budget, "Policies for Acquiring Commercial or Industrial Products and Services Needed by the Government," OMB Circular A-76 (Revised), March 19, 1979.

activities had been \$1.3 billion but was reduced 15 percent on average by in-house activities when they bid to satisfy the Performance Work Statement (PWS) with their most efficient organizations. Contractors' bids were 22 percent lower on average, even when Government supervision and administration costs were added to them. Despite the difference in average costs between in-house and contract bids, 48 percent of the competitions were won by the in-house activities, and the total annual cost of the 921 activities after competition was \$957 million, a 27 percent reduction as a result of competition.

FIGURE 1-1. THE ADVANTAGE OF COMPETITION



The Deputy Assistant Secretary of Defense (Manpower, Installations and Logistics) tasked LMI to determine how these savings had been attained. By analyzing both contracted BOS activities and in-house winners of CA competitions, we were to recommend how the factors that led to reductions in operating costs could be transferred to activities that had either not yet been

competed or were exempt from CA competition. Following discussions with the Services, the study focused on two functions, audiovisual services and family housing maintenance. After visiting 14 winning activities, we conclude that winners won by aggressively altering the way they do business, tailoring their workforce, organizations, and procedures to their local needs. They become sensitive to, and thoroughly familiar with the costs of their operations. We find several factors common to all winners and some that are unique to contractor operations; all of them are described in Chapter 2, "How Winner's Win."

Determining what the winners do differently than their in-house peers who have never faced competition is much less difficult than finding ways to transfer such practices to those in-house activities. The most obvious incentive for reducing operating expenses is the threat of losing the competitions, the very personal fear of losing jobs. Every activity manager we visited believed strongly that without such motivation, business as usual would have prevailed and the innovations that we observed would probably never have occurred. At one installation at which an activity had been scheduled for competition, a "Most Efficient Organization" (MEO) had been planned in detail, but when the competition was cancelled and the activity exempted from future competition, the MEO was shelved. The threat of competition was the only stimulus that produced savings.

How, then, can noncompeted activities be encouraged to try the new ideas suggested here? We recommend a three-pronged approach by CSD that involves:

- encouraging additional CA competition and establishing a clear goal of winning with the in-house work force;
- disseminating through the Efficiency Review Program information from Chapter 2 of this report on how the winners have organized their work forces and altered their procedures;

- disseminating the same information to installation commanders in the Model Installations Program.

#### RECOMMENDATIONS

We recommend that OSD encourage additional CA competitions and, more importantly, that it establish a clear goal of winning those competitions with the in-house work force. We suggest that OSD set a goal for in-house wins of 75 percent of all BOS competitions (versus the 48 percent winning rate in the 921 competitions we sampled) and that the Services be tasked to reevaluate the exempted status of those activities they have excluded from CA competition.

Since competition is the most effective means of promoting the types of economies we observed, it should be encouraged. With over half the CA competitions to date in BOS having been lost by in-house activities, the entire CA program has acquired a negative reputation. The Services have exempted more activities from competition than OSD would like, and we observed a very prevalent tendency on the part of activities that were scheduled to compete to postpone preparing for competition as if hoping that the threat would pass. As a result, activity managers often lose valuable time they need to acquire productivity-enhancing equipment and they find themselves reacting hastily to deadlines rather than executing a well-planned efficiency review. If the Services were encouraged to be more positive about the CA program, prompting earlier preparations by in-service activities and prevailing upon them to win, it is likely that competition would be even more aggressive and would produce greater cost savings than are now being experienced. Encouraging in-house wins should also foster a greater exchange of lessons learned between activities that have undergone competition and those preparing for it. Activity managers had an almost universal complaint that they were left to fend for themselves without benefit of lessons learned from others who had also faced

competition with contractors, and all said that in hindsight they would have prepared their bid differently knowing what they know now.

Our second recommendation is that the ideas presented in Chapter 2 be disseminated to activities exempted from competition through the Efficiency Review Program. That DoD-wide program is intended to duplicate the efficiency reviews that in-house activities conduct prior to CA competition for activities that are exempt from such competition. It requires preparing an in-house PWS, pricing out the PWS tasks in terms of manhours, materiel, and equipment, and formulating an effective mix of staffing patterns (full- and part-time personnel) and support resources to accomplish the PWS efficiently.<sup>2</sup> Key concepts presented in Chapter 2 should be considered in preparing the PWS, staffing patterns, and support resources during efficiency reviews. They should, therefore, be disseminated to responsible action offices by OSD.

Our third recommendation is that the ideas on how winners win be made available to installation commanders who participate in the Model Installations Program, a program that allows commanders of designated "Model Installations" to try new ideas and use any savings from their new ideas to improve facilities and service to their people.<sup>3</sup> We feel that the experiences of winners of contract competitions in BOS have proved that savings result from implementation of the ideas in Chapter 2, that such experience appears to be applicable to BOS activities at other installations, and that OSD should make it available to Commanders of Model Installations.

We do not recommend that any BOS activity in any of the Military Services be directed to use these ideas. Past experience has shown that little

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<sup>2</sup>Office of the Assistant Secretary of Defense (Manpower, Reserve Affairs and Logistics), "Performance Requirements and Efficiency Reviews -- Action Memorandum," 21 October 1982.

<sup>3</sup>Department of Defense, "1983 Annual Report of the Deputy Assistant Secretary of Defense, Installations," February 14, 1984.



improvement in efficiency results from directed changes of this type unless the activity managers and installation commanders are fully committed to the ideas. The best way to obtain such commitment is to demonstrate to them that the ideas work in actual practice in activities similar to theirs. Even then, it will take exceptional motivation and acumen for an activity manager to make extreme changes in the way he does business without the pressure of competition and the resultant drive toward self-preservation.

We have made additional recommendations for the Military Services in Chapter 3.

## 2. HOW WINNERS WIN

Winners win by being innovative, by familiarizing themselves thoroughly with their responsibilities, and by structuring their activities to meet those responsibilities as cost-effectively as possible. They change standard procedures and standard organizations where logic dictates that changes will reduce costs.

Our study concentrated primarily on audiovisual services and family housing maintenance (how these activities were selected is discussed in Appendix C), and we visited eight installations to observe 11 activities in detail. We also visited three total base maintenance contractors early in the study at the Navy Submarine Base, Bangor, Washington; Hawthorne Army Ammunition Plant (AAP); and Vance Air Force Base (AFB). Although only at Hawthorne AAP was base maintenance converted to contract as a result of a commercial activities competition under OMB Circular A-76, contracts had been recompeted in 1982 at the other two bases, and it was quite evident that the pressure of competition had been experienced by all three contractors. The installations and activities visited are shown in Table 2-1.

We observed many changes that these 14 activities made to help win their competitions and found that many approaches were common to in-house and contract winners. Those common approaches included:

- organizational changes;
- consolidation of working areas;
- use of working supervisors;
- use of multiskilled workers;
- use of lower-skilled workers;

- provision of equipment, vehicles, and communications;
- establishment of worker goals and accountability;
- provision of computer support;
- elimination of unnecessary work.

TABLE 2-1. INSTALLATIONS VISITED AND ACTIVITIES COMPETED

| INSTALLATION<br>VISITED | ACTIVITY<br>COMPETED       | WINNER   |            |
|-------------------------|----------------------------|----------|------------|
|                         |                            | IN-HOUSE | CONTRACTOR |
| Keesler AFB             | Audiovisual Services       | X        |            |
|                         | Family Housing Maintenance |          | X          |
| Hill AFB                | Audiovisual Services       | X        |            |
|                         | Family Housing Maintenance |          | X          |
| PWC Pensacola           | Family Housing Maintenance | X        |            |
|                         | Vehicle Maintenance        | X        |            |
| Fort Jackson            | Audiovisual Services       | X        |            |
| Cherry Point MCAS       | Family Housing Maintenance | X        |            |
| Camp Lejeune            | Family Housing Maintenance | X        |            |
| Fort Sheridan           | Audiovisual Services       | X        |            |
| Offutt AFB              | Family Housing Maintenance | X        |            |
| Submarine Base, Bangor  | Total Base Maintenance     |          | X          |
| Hawthorne AAP           | Total Base Maintenance     |          | X          |
| Vance AFB               | Total Base Maintenance     |          | X          |

We also found several approaches commonly used by contractors but not by in-house winners. The following sections discuss each of the approaches common to the winners and those common to contract winners only.

#### ORGANIZATIONAL CHANGES

As a result of competition, organizational changes have been made at many of the activities visited. It is apparent that competition forces managers to examine their organizational structure rigorously to determine areas in which changes might permit reductions in the number of employees, especially costly

supervisors, or in which a modified organizational structure might allow the activity to tailor its form to fit local needs better. The most innovative reorganization we saw was at Vance Air Force Base where the contractor has made substantial changes to "fine tune" the operation; organizational changes were also noted during visits to several other installations.

At Vance Air Force Base, the winning contractor, Northrop Worldwide Aircraft Services, Inc., has very boldly reorganized its support activities to take advantage of characteristics peculiar to that base. It frequently organizes around facilities it occupies or around key employees so that it can use these assets to their best advantage. By combining three separate functions -- supply, transportation, and procurement -- as branches of a department it calls STP, Northrop experienced very favorable results. Because they are located in the same building, the procurement and supply branches have been able to streamline the materials-receiving process, allowing item discrepancies to be detected very early. The Procurement Office has its own terminal for the supply computer and routinely queries the system for the status of orders without inconveniencing a supply specialist. The proximity (both physically and organizationally) of supply and transportation greatly speeds the repair of supply's materials-handling equipment (it is sometimes even repaired in the warehouse) and allows transportation's vehicle maintenance supervisor to obtain parts more quickly. Since they all work in the same department, the various components of STP have less need for interfacers to communicate the needs of one organization to another. Additional or collateral duty positions such as vehicle control officer and supply account managers, common in Air Force support activities and requiring training of people from outside those fields, are centralized within STP under the branch most familiar with the requirements of the job.

Since STP has warehouse space and stock control skills, Northrop's management decided to include forms and publications distribution under its Supply Branch. By doing so, it has vastly reduced the handling of these items and removed from Base Administration a very cumbersome responsibility. Other STP organizational changes include the placement of the Packing and Crating Section under the Supply Branch (rather than under the Transportation Branch), since supply is its most identifiable user. The transportation officer and vehicle maintenance superintendant's responsibilities were combined into one organizational block around a capable manager to maximize the use of his skills. A forward supply warehouse has been opened on the flightline, taking advantage of an available facility.

Northrop has also made other organizational changes at Vance Air Force Base. In the Civil Engineering Division, several staff functions, such as administration, training, financial management, and real estate management, have been made a part of the Industrial Engineering Branch. Instead of four or five work force superintendants, the Operations Branch has none, grouping all of its shops under two foremen and designating "working leadmen" for most shops. Even at the shop level, Northrop has combined similar functions; for example, the structures leadman oversees both the structures and metal shops. Vance Air Force Base has no Deputy Base Civil Engineer; a branch chief is designated as the Division Chief's substitute in his absence.

This streamlined organization has eliminated many supervisors, but Northrop maintains that it has not hurt its capabilities and has vastly streamlined its work flow and response times.

We saw organizational changes in the family housing maintenance and audiovisual services activities we visited also. At the Public Works Center (PWC), Pensacola, Cherry Point Marine Corps Air Station (MCAS), and

Camp Lejeune, family housing maintenance responsibilities had been shared by the base maintenance shops before CA competitions. Although some employees worked practically full-time on housing maintenance, they were assigned to shops that maintained more than just housing. The need to compete family housing maintenance as a package effectively forced managers to create a separate organizational block in which to group such workers. When combined with the use of multiskilled workers and lower grade levels, the separate shop produced less organizational friction than we saw at one location that had not reorganized. Offutt Air Force Base has a Family Housing Maintenance Shop, but it is very small and is dedicated primarily to renovating units between occupants; the other Civil Engineering shops do most of the repair work. Because housing maintenance responsibilities are so fragmented, it is entirely possible for two separate crews to be sent to the same housing unit at the same time on similar jobs. Furthermore, some of the workers in the Family Housing Maintenance Shop are discontent with doing work similar to that done by higher-graded specialists from Civil Engineering's other shops.

While organizational changes in family housing management generally consisted of the establishment of a separate Housing Shop, in audiovisual services we saw a variety of organizational changes. At Fort Jackson, the Training Devices and Graphics Sections have been combined into a single section, allowing the elimination of one GS-11 supervisor's position. Keesler Air Force Base has decentralized its work processing responsibilities, allowing sections (and even individuals) to do their own scheduling and eliminating a block on their organizational chart. Hill Air Force Base is now in the process of combining its film library and administrative sections.

The key to these organizational changes is that competition forces managers to be more flexible and to tailor their organizations to local needs,

local facilities, and even local personnel. Gone is the tendency to follow a common organizational chart simply because it conforms to a standard when an activity's very survival depends on its operational efficiency.

#### CONSOLIDATED WORK LOCATIONS

Military installations frequently have two or more housing maintenance shop locations because housing is often dispersed over large areas. One shop generally serves as the central site, while the others are more limited in scope and are considered satellite shops. Satellites are stocked with their own parts and supplies, their own sets of shop tools and equipment, and their own staff, usually including a supervisor. Since shops of that kind are separate operating units requiring the same types of support as the central shop, savings can be realized in several different ways through consolidation. First, satellites are generally staffed all year for their average peak work load. Merging the satellite work force with the main shop gives managers a broader pool of workers to assign to tasks and can enable the shop to operate with fewer total authorized spaces. Second, a merger can free the satellite foremen of supervisory responsibilities, allow them to return to workman status, and eliminate supervisory positions with savings for the organization. Third, since supplies no longer need to be stocked in multiple locations, savings can be realized from lower total stockage levels.

After analyzing the cost of operating satellite shops, several of the installations we visited decided during competition that the added convenience of multiple locations was not cost-justifiable, particularly if one or more supervisory positions could be eliminated through consolidation. Both the contractor at Hill Air Force Base and the in-house operation at Camp Lejeune have achieved efficiencies by closing satellite shops. Before competition, Camp Lejeune operated a central trade shop and several emergency service shops



dispersed around the installation. They closed several satellite shops but, because of the unusually large size of the base, could not justify closing all. At Hill AFB, two shops had served housing areas on opposite ends of the base. Despite the 3-mile distance between areas, the contractor closed one of the shops and has been operating with a single shop for the past 5 years.

Satellite shops are usually established because of widely scattered housing areas, so a consolidated location cannot be considered unless workers have radio (or beeper) contact with supervisors and have adequate transportation to move from one job site to another. This communication enables the supervisor to assign tasks to the work force on a real-time basis regardless of the distance from the shop, and it facilitates the coordination and delegation of tasks. Each worker at the family housing maintenance shops at Hill AFB and Camp Lejeune has a radio and a dedicated vehicle.

The location of audiovisual shops has also been consolidated by some audiovisual winners. Before CA competition at Keesler Air Force Base, for example, five or six separate graphics shops were located throughout the base. Each was near a customer organization, served that organization's needs, and as with the satellite shops in family housing maintenance, required its own people and equipment, with little interchange between shops. Since the workload for each shop was extremely variable, one office might be overloaded while another was in a slack period. Since CA competition at Keesler AFB, all graphics work has been merged to a single location and the number of employees has been reduced from 45 to 23. The level of service to customers remains high.

Consolidation has been an effective means for reducing operating costs at many installations but should be used only if the level of customer service

can be substantially maintained. Otherwise, the change would be counterproductive and should not be considered.

#### WORKING SUPERVISORS

Hand in hand with organizational changes, we found the use of working supervisors to be prevalent among winners. Again, the most visible examples were in base maintenance at Vance Air Force Base where Northrop has eliminated shop foremen in the Civil Engineering Division and substituted "working leadmen" whom they consider technical supervisors. Leadmen do not concern themselves with performance ratings, employee counseling, and the like, all of which are the responsibility of a supervisor higher in the organizational structure. Northrop claims that much of the time other organizations spend supervising is not entirely necessary and that a good supervisor has the potential for a far greater span of control than standard military organizational doctrine acknowledges. It is unnecessary, in Northrop's view, to have the number of supervisors normally found within a typical Air Force civil engineering organization. The working leadmen charge much of their time to direct labor and seem quite satisfied that their years of experience in a craft have not resulted in a supervisory desk job, a fate they consider less than palatable.

There are many other examples of working supervisors at Vance Air Force Base, such as the vehicle operations leadman who does a considerable amount of driving himself. The other base maintenance contractors visited also depend on working supervisors, having formally designated jobs as leadmen, working leaders, or the like.

In family housing maintenance and audiovisual services, supervisors were also expected to perform direct work, but the designation of working supervisors was somewhat less formal. Instead of reclassifying positions as

working leaders, the in-house winners often eliminated supervisory positions in preparation for competition, and the work that they used to provide has simply shifted elsewhere within the organization. Usually the formal supervisory responsibilities (employee selection, evaluation, counseling, etc.) have moved higher in the organization, while the technical supervision (quality control, work scheduling, etc.) has moved down. These changes have effectively increased the span of control of designated supervisors and have, where properly communicated to workers, made the work force more cognizant of the fact that it must police itself. Workers are more responsible than they once were to assure that the quality of their work meets standards.

#### MULTISKILLED WORKERS

Both contractors and in-house winners rely on multiskilled workers to help them satisfy periodic changes in work load. They also find that this approach increases the productivity of workers whose jobs have extensive amounts of slack time. Many of the illustrative examples came from the total base maintenance contractors visited early in the study.

At the Navy Submarine Base, Bangor, for example, the contractor, Pan American World Services, Inc., operates 29 buses and yet has only 15 full-time drivers. When more than 15 buses are needed, grounds maintenance workers (each of whom has been trained and licensed to operate buses) are temporarily assigned as drivers. Pan American enthusiastically endorses the concept of multiskilled workers and emphasizes cross-training of employees as its highest priority during slack periods. A multiskilled roving patrol is used to operate boilers and air-conditioning systems, eliminating the need for separate patrols from each trade. The company's nonunion work force allows Pan American a great deal more latitude in designating multiskilled positions than other total base maintenance contractors visited.

At Vance AFB, Northrop has combined its pavements and heavy equipment operations sections into a single shop, cross-training employees in both fields. Since pavements workers are licensed to operate all types of heavy equipment, much of the time that was once lost waiting for an equipment operator is now spent productively. A single electrical shop maintains both interior and exterior electrical systems as well as auxiliary power generators. Two general-purpose maintenance mechanics are dedicated to family housing maintenance and repair, and they perform handyman work ranging from simple carpentry and painting through electrical and mechanical work. Northrop frequently uses multiskilled positions to keep workers productive during slack periods. For example, the night clerk at the base billeting desk performs necessary accounting and auditing work, the maid service supervisor assists the billeting clerk during the day, Civil Engineering Division work force controllers double as service call clerks, and the night controller keeps busy by updating labor accounting records. Multiple skills also prevent Northrop's organization from becoming too dependent on a single individual. Two employees staff the Family Housing Management Office, and both of them double as assignment clerks and inspectors for Vance Air Force Base's 220 housing units. Procurement buyers handle an order from start to finish, remaining proficient in all aspects of purchasing rather than merely in one small facet. The company claims that this diversity of skills allows it to continue operating much more smoothly whenever key workers are absent.

Northrop's use of multiskilled workers is not as widespread as it was before the company's employees organized in 1976. Since then, it has experienced union resistance, for example, to its policy of covering all nighttime emergencies in Civil Engineering (no matter what trade is called for) with a standby electrician or refrigeration mechanic; it is, however, continuing the practice.

In the audiovisual and family housing maintenance fields, commercial activities competition winners also use multiskilled workers. General-purpose maintenance mechanics, similar to those at Vance AFB, were used extensively by all six of the contractors and in-house family housing maintenance winners visited. When coupled with other productivity-enhancing ideas, such as dedicated and stocked vehicles and radio communications, the use of multiskilled workers allows maintenance managers to complete more service calls while sending fewer workers to houses and completing more tasks per trip than would otherwise be possible. Multiskilled workers allow reductions in the number of supervisors since organizational grouping by trades is no longer necessary. Before competition, the 23-person Family Housing Maintenance Shop at Keesler Air Force Base had five supervisors to oversee individual trades. The contractor now has 19 employees but only one supervisor. Keesler's Manpower Office views the failure of the in-house competitor to consider multiskilled workers as the main reason for the loss of the competition to a contractor. In-house winners placed greater dependence on multiskilled workers after their CA competitions.

In the audiovisual field, the use of multiskilled workers is somewhat less prevalent although still notably expanded as a result of competition. Photographers frequently do both developing and printing, but that approach is not uncommon in activities that have not experienced competition. What we did find unique is that at Fort Sheridan photographers are tasked to do computer graphics when work loads dictate, and they have adapted well to this new endeavor. Managers of the graphics section at Keesler AFB have engaged in a tremendous push away from specialization and told us that multiskilled illustrators can not only be moved from specialty to specialty when work loads change, but that by rotating an employee between specialties, managers can

more easily see where employees excel. The employees develop a broad skill base and are more interested in remaining with the organization since they are better qualified for job progression than they would be if they specialized.

Multiskilled workers allow management the flexibility it needs to keep an austere work force at peak productivity.

#### LOWER SKILL LEVEL

Many installations visited were able to reduce their operating costs by lowering the average skill level of their work force without lowering the level of service provided to the customer. In most instances, this action was taken after in-house management engineers had conducted a thorough analysis of the work performed and determined that some positions were graded at a higher level than required.

Before competition at PWC Pensacola, for example, all mechanics in the light vehicle transportation shop were graded as WG10s. An analysis of their work load revealed that WG10-level experience was needed only for major overhaul jobs; replacement of parts and tire repairs could easily be handled by WG6s and WG5s. Consequently, all but two positions were downgraded.

Similarly, tradesman positions in family housing maintenance at Pensacola were typically classified at the WG8 level. In preparing for competition, the PWC determined that 85 percent of the work could be performed by a WG7 or lower. Consequently, all positions except one air conditioning maintenance position were downgraded. At Cherry Point MCAS and Camp Lejeune, the skill level of many family housing maintenance positions was lowered from journeyman to maintenance mechanic or helper, and at Keesler Air Force Base, several positions in the photo lab were lowered from the GS-7 to the GS-5 level.

The use of lower skill levels not only creates cost savings for the organization but also provides employees with career progression incentive

within the organization. For example, when all mechanics in the transportation shop at Pensacola were graded as WG10, there was little competition for career growth and advancement. With the new WG5 and WG6 positions, individuals can start as helpers and, as they demonstrate that their skills increase, can advance to the level of skilled mechanic. This provides a new employee with the opportunity to start at a semiskilled level and progress within a specialty without having to leave the organization. These lower positions are not trainee positions, but they do give lower-skill workers chances to learn their trades and to advance their careers within a single organization.

In the past, the BOS work force has been structured and graded so as to have the most qualified worker available for the job. This approach is being recognized as a luxury that an activity simply cannot afford in the face of competition. The newer practice of assigning a job to a qualified worker in the lowest possible grade is more aligned with the spirit fostered by CA cost competitiveness.

#### EQUIPMENT, VEHICLES, COMMUNICATIONS

Commercial activities competition winners are acutely aware of the value of a worker. Labor costs are the predominant part of either a contractor or an in-house winner's total operating budget, and managers devote a significant portion of their efforts to making sure that they get the most out of every worker. They consider their workers as major investments, and do not hesitate to make further, smaller investments that will amortize themselves in improved worker productivity. We found that competition forces managers to search more actively for such investments and creates a heightened sense of urgency to acquire productivity-enhancing assets quickly. Particularly noteworthy is the fact that in-house winners appear to be even more aggressive in the acquisition of such assets than contractors.



At Camp Lejeune, the family housing maintenance operation has been vastly streamlined by communications and vehicle acquisitions. When a trouble call is received in the Family Housing Office, a job ticket is written at the trouble desk and is simultaneously transmitted to an automated ticket-writer in the Maintenance Shop. There, it is received by a dispatcher and, if it is for high-priority work, it can be immediately radioed to a mechanic. Since each mechanic has a truck stocked with parts and tools, the mechanic may proceed directly to the job site and complete the work without having to return to the shop.

Radios, automated ticket-writers, and a vehicle for every worker would sound very appealing to most in-house family housing maintenance operations, but they would hardly hope to obtain them. It is interesting to note, however, that not only Camp Lejeune but also FWC Pensacola and Cherry Point MCAS had a vehicle for every housing maintenance worker, as did contractors at Keesler and Hill Air Force Bases. In fact, only the in-house CA winner at Offutt Air Force Base did not have a vehicle for every craftsman. At non-competed activities, in contrast, the typical allocation of vehicles is one for every two to four workers (depending on Service and Command) for in-house activities. It was clear that local management had recognized early in its preparations for CA competition that housing maintenance workers without transportation are not only nonproductive but also require other workers to taxi them from job to job. To make matters worse, without their own vehicles, the workers can often find themselves without the necessary part or tool to complete the job and have to call for transportation back to the shop to get the needed part. A single job could easily tie up two workers for four one-way trips! Both Camp Lejeune and Cherry Point MCAS feel that vehicles and radios are the keys to maximizing productivity, reducing the size of their

work forces, and winning their competitions. Both installations requested extra vehicles, and neither was able to obtain them. To win the competition, each was forced to reallocate vehicles from other activities on the installation to family housing maintenance.

Aside from vehicles and radios, we did not find an abundance of productivity-enhancing equipment purchased for family housing maintenance workers because of CA competition. Each manager told us about heavy use of power tools, and we observed that two had purchased airless paint-spraying equipment. However, it is not clear that competition provided the impetus for those purchases. What is interesting is that family housing maintenance managers appear to shun the fast-payback, capital-equipment funds the Services have established for the very purpose of providing productivity-enhancing equipment (e.g., the Air Force's FASCAP program), considering them too difficult to use because of the amount of justification that must be provided.

In audiovisual services, we saw much more attention paid to improving employee productivity with equipment. The in-house activity at Hill Air Force Base has purchased a color print processor that reduces the time to produce a dry print from 5 minutes to 48 seconds. The processor takes less than 2 minutes to clean (the older version took well over 1 hour) and has premixed, ready-to-use chemical kits. Hill AFB has also purchased an ultrasonic rack and tray cleaner to reduce time spent in that effort and has modified its Kodak 8S Color Printer to handle black-and-white prints at a much faster rate than was previously possible. A microprocessor-controlled enlarger head automatically selects correct filters for exposure, eliminating much trial-and-error printing of enlargements. At Fort Sheridan, an automatic slide collator that quickly separates multiple copies of slides (a task that previously had been done by hand) and a color slide processor reduce the cost

of producing a slide from 35¢ to approximately 11¢ and, more importantly, free workers for other tasks. Audiovisual managers do not seem to be using fast payback investment funds either, and have sometimes resorted to leasing equipment rather than purchasing it when they feel they may obtain it more quickly.

Managers of in-house activities that have won CA competitions seem much more keenly aware than their counterparts who have not competed that vehicles, equipment, and communications systems are worth fighting hard for, and they seem to put a great effort into being aware of what is available and obtaining assets they feel they can justify.

#### WORKER GOALS AND ACCOUNTABILITY

Although equipment, vehicles, and communications are designed to make individual workers more productive, the most important challenge to base support managers, whether contractor or in-house, is to obtain a positive internal commitment from the workers to do their work quickly and well. All too often, workers in support activities are indifferent to the base's mission and, because they have no clear-cut goals, they feel no real need to push themselves hard to do a good job.

As expected, contractors were generally found to have an edge over in-house activities in providing a goal for their workers. Contractor's profit incentives and customer/client relationships make it easier for them to convey to employees what is expected of them. Both Pan American and Northrop strongly stress to their employees that the satisfaction of their Navy and Air Force customers is paramount, and the result is quite visible in the way the employees treat their customers. It is clear that the negative aspects of working for a contractor, particularly the relative insecurity of employment by a company that could lay off an employee almost instantly, keeps workers on their toes; however, something more has been done to activate them into a

positive, synergistic work force. Day & Zimmermann/Basil (DZB) Corporation's site manager at Hawthorne Army Ammunition Plant told us that DZB's employees are keenly aware that the company's very survival rests in their hands, and this thought provides motivation to produce at the highest level possible.

For in-house winners, activating workers is considerably more difficult. Employees usually perceive the whole CA process as an attempt by the government to take advantage of them, and the reductions in force, grade reductions, and increased per capita work load that follow an in-house win can hardly be expected to increase morale and commitment. The only positive aspect from their perspective is the thought that they have faced direct competition with a skilled contractor and won. The more skillful managers with whom we spoke had used this emotional issue to the limit. The transportation manager at PWC Pensacola has even framed the formal summary of bids for his light vehicle maintenance activity and displayed it prominently so that all could see how they beat the contractors.

Unfortunately, the thrill of having won a competition is short-lived, and employees are soon disenchanted when they find themselves working harder than ever for the same or sometimes lower pay. The better managers of in-house activities have worked hard to create goals for workers to meet or exceed so that they might have a means of gauging their contribution to the overall work effort. The most impressive example that we saw was in family housing maintenance at Camp Lejeune.

Family housing maintenance is not an easy area in which to establish worker goals; the most commonly used method for measuring adequacy of work done is the number of customer complaints received. At Camp Lejeune, the PWS for family housing maintenance was written as an indefinite quantity contract,

and both Government and contractor bids had to be based on a cost-per-unit-of-work basis in several work categories. To prepare the Government's bid, the Maintenance Division performed a detailed audit of all work done over a specified period and used both Engineered Performance Standards and locally developed standards to set unit prices. In order to ensure that costs were kept within contract tolerances, it was necessary to set up a new cost-accounting system, which was done soon after the Government won the bid.

The family housing worker goals came into being almost by accident. Management attempted to explain the new cost-accounting system to workers, telling them that work would be categorized in conformity with the contract and that both time charged and units of work completed would be collected for each job. For the workers, the very complexity of the system seemed to raise more questions than it provided answers. Management tried to simplify its explanation and ultimately produced a one-page summary of unit standards (in minutes) for each category of work in the contract (Figure 2-1). The workers were each given a copy of the standards and told that they were expected to complete any job they were assigned within the standard time. They were also told that the cost-accounting systems could accumulate results by employee so that an employee's performance could be compared with the standards. The result has been overwhelming. The workers have adopted the standards as goals to exceed, and they have done so at a very impressive rate. They seem to welcome the existence of a goal to work toward, and both morale and productivity in the family housing maintenance shop are quite high.

The establishment of worker goals, be they standards, profit targets, cost limits, or levels of customer satisfaction, was prevalent within activities that had won contract competitions. It appears that organizations that have concentrated heavily on such goals and that have held workers accountable

to them are more productive and secure a higher level of employee morale and loyalty than those that have not.

FIGURE 2-1. FAMILY HOUSING MAINTENANCE CONTRACT ENTITLEMENTS  
1 FEBRUARY 1982

| CONTRACT<br>LINE NO. | DESCRIPTION                | UNITS | AVG.<br>TIME<br>ALLOW-MIN. | CONTRACT<br>LINE NO. | DESCRIPTION                | UNITS | AVG.<br>TIME<br>ALLOW-MIN. |
|----------------------|----------------------------|-------|----------------------------|----------------------|----------------------------|-------|----------------------------|
| 01                   | Ext. Walls                 | SY    | 7                          | 28                   | Bird/Animal/Fest Remv.     | C     | 73                         |
| 02                   | Int. Walls & Ceilings      | SY    | 8                          | 29                   | Tenant Ret. Room (TRM)     | C     | 3                          |
| 03                   | Wallpaper                  | SY    | 14                         | 30                   | Refrigerators/Ranges       | C     | 34                         |
| 04                   | Comm. Floors or Subfloor   | SY    | 23                         | 31                   | Other Appliances           | C     | 34                         |
| 05                   | Fin. Hardwood Flooring     | SY    | 13                         | 32                   | Elec. System               | C     | 43                         |
| 06                   | Carpet - Install           | SY    | 3                          | 33                   | Plumb. Syst. Repair        | C     | 36                         |
| 07                   | Carpet - Clean             | SY    | 2                          | 34                   | Plumb. Flt. Rpt.           | F     | 163                        |
| 08                   | Lin/Car/Vinyl Tile         | SY    | 8                          | 35                   | Heating System, Rep.       | C     | 28                         |
| 09                   | Furniture Seals            | LF    | 3                          | 36                   | A/C Syst. Rep.             | C     | 42                         |
| 10                   | Int. Door & Frame          | C     | 37                         | 37                   | Heat Pump Rep.             | C     | 33                         |
| 11                   | Window Screens             | C     | 38                         | 38                   | AC/Heat Pump Comp. Install | F     | 361                        |
| 12                   | Screens/Storm Door         | C     | 33                         | 39                   | A/C Checkout               | C     | 70                         |
| 13                   | Ext. Door & Frame          | C     | 73                         | 40                   | Heating Syst. PH           | 36    | 78                         |
| 14                   | Window and Frame           | C     | 53                         | 41                   | Heat Pump Checkout         | C     | 42                         |
| 15                   | Reglase Window/Door        | SY    | 32                         | 42                   | Filters                    | DU    | 11                         |
| 16                   | Locks                      | SY    | 3                          | 43                   | Moving                     | A     | 43                         |
| 17                   | Roofing                    | SY    | 3                          | 44                   | Clean-up                   | A     | 4                          |
| 18                   | Gutter/Downspout/Clean If. | C     | 99                         | 45                   | Lawns/Fine Strw            | A     | 36                         |
| 19                   | Fences, Gates, Etc.        | C     | 132                        | 46                   | Tree/Shrub Trim            | C     | 82                         |
| 20                   | Cabinet Repair             | C     | 18                         | 47                   | Drainage                   | CF    | 31                         |
| 21                   | Cabinet Replace            | U     | 264                        | 48                   | Evacuum Control            | SY    | 2                          |
| 22                   | Lock Ice                   | E     | 31                         | 49                   | Concoidal Service          | E     | 1188                       |
| 23                   | Keys                       | E     | 4                          | 50                   | COOB-Sensib.               | E     | 177                        |
| 24                   | Room Accessories           | C     | 37                         | 51                   | Repl. Above Grd. Fuel Tank | E     | 153                        |
| 25                   | Supporting Accessories     | C     | 49                         | 52                   | Repl. Under Grd. Fuel Tank | E     | 603                        |
| 26                   | Blinds/Nodes/Thermal Rpt.  | E     | 39                         | 53                   | Lawns                      | E     | 216                        |
| 27                   | Blinds/Nodes/Thermal Rpt.  | E     | 34                         | 54                   | Down Time                  | E     |                            |

LEGEND OF UNITS: C - Service call; SY - Square foot; SF - Square yard; LF - Linear Foot; U - Units; E - Each;  
A - Area; CF - Cubic Yard; DU - Dwelling Unit.

### COMPUTER SUPPORT

With the sharp reduction in manpower experienced by many in-house winners and the advent of powerful, affordable microcomputers, we expected to find many bases using computers to perform routine repetitive tasks. Unfortunately, only a few of the bases are able to assemble the expertise, available manpower, and budget to do so.

At Fort Sheridan, computers are being used as productivity-enhancement tools to generate products that were once produced by hand (and which could be again if necessary). We observed two distinct uses of computers at Fort Sheridan. First, a Franklin computer is used for "image processing" in

the graphics shop. Image processing utilizes computer graphics software to lay out and compose charts, graphs, or other visual products on a screen before they are produced in hard copy. This procedure allows the graphic artist to visualize, test, and revise the product on the computer rather than having to produce successive hand-drawn products. The second observed use of computers is for administrative functions such as labor accounting, customer billing, and supply inventories. Since Fort Sheridan provides many of its services on a reimbursable basis, cost data must be collected, stored, and processed for accounting and billing purposes. The personal computer is ideal for that use. By using an off-the-shelf data base package to create a simple cost-accounting system and by having all employees log and submit their billable time each week, the office can in minutes produce customer bills that once took hours. The machines used for these tasks, an IBM Personal Computer and an Osborne, are owned by individuals in the audiovisual shop who have a personal interest in computers and who recognized the potential for labor savings through automation. One reason that Fort Sheridan has been able to automate so effectively is that these individuals have been willing to use their own machines and to spend their own time learning to apply the computer's capabilities to the requirements of the office.

PWC Pensacola also acquired a personal computer, a Tandy TRS80, which it is using in the Transportation Shop for a number of tasks. Preventive maintenance histories and schedules for all vehicles stored in its files are used for projecting maintenance work loads and for reminding customers to bring in their vehicles for maintenance. All maintenance performed on a vehicle is recorded and stored so that the vehicle history is available for identifying recurring problems and tracking life-cycle costs. The computer is also used by the vehicle dispatcher. As at Fort Sheridan, a critical factor in using



the computer effectively is the availability of staff members who know how to use the system and how to apply it to the task at hand. Pensacola hired a college student on a part-time temporary basis to write the initial programs but has not been able to include computer skills in the descriptions of any current staff position. This lack of expertise has prevented any additional software development and has hampered the office in fully utilizing this resource.

It appears that many BOS tasks lend themselves to automation. Unfortunately, an installation has many hurdles to overcome before establishing itself as a computer user. First and foremost is the significant predisposition by Services towards centralized systems management, which discourages the acquisition of hardware and the development or application of software by a base-level activity. Locally tailored systems, such as those observed at Fort Sheridan and PWC Pensacola, are generally discouraged. The second hurdle is that positions must be realigned and individuals trained before an activity can become computer-capable. Financing of hardware also needs to be addressed; PWC Pensacola, an industrially-funded activity, had less of a problem acquiring hardware than does Fort Sheridan, where most of the computers being used are owned by employees. Given the many obstacles to becoming automated, it is understandable that the use of microcomputers is still uncommon in audiovisual and family housing maintenance offices.

#### ELIMINATE UNNECESSARY WORK

As a result of CA competition, BOS managers are taking a hard look at the work performed by their staffs and are eliminating or modifying tasks they consider unnecessary. This change has not been easy. Over the years, support organizations have been justifiably proud of the very high levels of service they gave their customers. Service above and beyond standards was willingly provided and had come to be routinely expected.

With CA competition and the consequent reduction in manpower, managers feel compelled to find ways to maintain an acceptable level of service with reduced resources. They seem to recognize that it would not make sense to write a contract that provided higher-than-standard levels of service since its cost would be prohibitive. This recognition has created a new environment that does not allow many of the old practices to continue. In-house activities that win competitions must now operate as in-house contractors, with a fixed budget and a detailed PWS, and tasks routinely performed before competition can be continued only if they are included in the PWS. From these changes, a new relationship with the customer is developing.

At PWC Pensacola, the Transportation Shop compares the Navy's vehicle maintenance intervals with those of the manufacturers, and in cases in which the Navy interval schedules are more stringent, the manufacturers' intervals are followed. The transportation manager reasons that the additional maintenance required by Service regulations is unnecessary and was successful in receiving a waiver from NAVFAC P-300 to convert to manufacturers' intervals.

The contractor at Hawthorne AAP avoids what it calls "tinkeritis," which is the tendency to create new problems by tinkering with a sound vehicle. It avoids disassembling inexpensive parts for routine maintenance when a policy of "replace it when it fails" is more cost-effective for the Army.

At many military installations, multicolor overhead transparencies are a standard product of the audiovisual shop. Both Keesler and Hill Air Force Bases and Fort Sheridan have stopped producing transparencies of this type and now produce only single-color transparencies. Keesler Air Force Base has not only eliminated expensive transparencies but has also simplified many of its other audiovisual products: in place of complex graphics, simple line drawings are often used; past products are saved and reused for other jobs;

and self-help areas are emphasized, allowing users to produce products such as Thermofax slides for themselves.

Finally, the Family Housing Maintenance Office at Pensacola cut its scheduled maintenance work load from 8.0 to 0.3 staff years when it recognized that most of the 8 staff years of work was scheduled but never performed. It became obvious that the schedule was generally ignored and needed to be scaled down to a realistic level. After analyzing historical data from the past few years, the 0.3 staff year figure was agreed upon. Homeowners' responsibilities were redefined to include some maintenance, such as furnace filter replacement, and maintenance on some items was simply stopped when it was found not to be cost-effective. The Family Housing Maintenance Office cites as an example that hot-water-heater maintenance is no longer being performed under the theory that it is less expensive to fix the heaters when they fail than to continually maintain them.

Cherry Point MCAS took the bold step of charging tenants a fee for certain types of house calls. Tenants who lock themselves out of their home, are not home for a scheduled maintenance appointment, or have damaged the house through negligence are charged for maintenance services. The purpose of this policy is to raise the tenants' awareness of their own responsibilities and to reduce the amount of unnecessary family housing maintenance work. Camp Lejeune has trained its operators on the incoming call desk to ask the tenant a series of questions and to request that the tenants themselves perform simple tasks such as resetting a tripped garbage disposal circuit breaker.

#### CONTRACTOR-SPECIFIC APPROACHES

To reduce the costs of their operations, contractors have taken some additional steps that we did not observe among in-house winners. Although

many of these steps would have merit in an in-house setting, they apparently have not been considered, perhaps because they would require extra effort by other support activities that were not themselves threatened by competition.

#### Overtime

Overtime is frequently used by contractors to meet periodic peaks in work load. Contractors use overtime to allow for even more reductions in manpower levels, and they seem to encourage its use. Northrop's site manager at Vance Air Force Base told us that he considers a section that does not regularly use overtime to be overstaffed and takes action to reduce its size. In-house winners told us that they did not plan on the use of overtime for normal day-to-day business, considering it only for emergencies or when vacancies cause work to back up. The impression they seem to have is that overtime is an indication of poor management and that installation commanders make it clear that overtime is to be avoided whenever possible.

#### Part-Time Labor

Part-time labor is viewed in much the same light as overtime. Contractors often hire off-duty military or their dependents for jobs that do not require full-time employees. At Vance Air Force Base, after-hours refueling of aircraft is done by part-time workers, the job requiring only a few hours of work each evening. Contractors consider military dependents as a resource that can be easily attracted to part-time jobs conveniently close to their homes. The in-house winners we visited do not use part-time labor, with the exception of the student summer employees we observed at two locations, because they are under the impression that personnel offices cannot hire part-time workers. It should be noted, however, that full-time temporary workers are frequently used by both contractors and in-house organizations to meet seasonal work loads, such as the heavy summer turnover of family housing units.

Simple Supply Procedures

Contractors have taken steps to reduce the time workers spend waiting for parts significantly by establishing relationships with jobbers for common, inexpensive items such as building hardware or photographic supplies. In-house winners are usually constrained to the use of a cumbersome supply system that seems to emphasize competitive prices, often at the expense of response time. To a contractor, it makes no sense to haggle over a small price reduction if a worker is standing idle at great expense. In-service winners agree but indicate that it will take more momentum than they can provide to change their sources of supplies.

Responsive Vehicle and Equipment Maintenance

Like a worker without a part, a worker without transportation or equipment is of little benefit to a contractor, so most contractors we visited go to extraordinary steps to make sure that each worker has the transportation resources needed. We have already stressed the importance winners place on vehicles in family housing maintenance. At Hawthorne Army Ammunition Plant, Day & Zimmerman/Basil Corporation has gone so far as to perform all routine vehicle maintenance at night to preclude a worker from being without a vehicle during working hours. The housing maintenance contractor at Hill Air Force Base has a loaner vehicle to be used when a worker's vehicle is out of commission. In-service winners often complained to us that they are at the mercy of another organization when it comes to vehicle maintenance and that vehicles are scheduled for routine work without regard to the user's work load or needs. They seem unable to change this procedure except at FWC Pensacola where Vehicle Maintenance is a FWC activity. There, housing maintenance personnel may rent another vehicle from the pool when their vehicles are being serviced.

While it appears that many of the contractor-specific approaches above could be adopted by the Services internally, two of the ideas that contractors use -- lower wages and quick personnel turnover -- are not within DoD's ability to independently control.

#### Lower Wages

The contractors we visited paid lower wages than the in-house activities they replaced. Contractors must pay at least the minimum wages called for in their contracts under the provisions of the Service Contract Act (41 U.S.C. §351-357). These minimum wages are determined by the Bureau of Labor Statistics on the basis of a survey of local collective bargaining wage rates or a survey of local industry wages (without restriction to industrial classification code and specific to the trade or trades in question). Government wages, on the other hand, are based on surveys performed by OSD's Wage Fixing Authority. Those surveys are restricted to specific industrial classification codes (for example: local and state government wages are not sampled) and are not trade-specific. In common trades such as plumbing, carpentry, and the like, we found the Service Contract Act wages to be lower than the wages Government employees receive for the same job. We were told by OSD's Wage Fixing Authority that this is not so for other blue collar workers, particularly aircraft mechanics, who are paid much higher wages in the private sector.

The problem is that contractors are able to bid at a lower hourly labor rate for A-76 competitions in audiovisual and family housing maintenance services, and this lower rate biases the costs in their favor. Circular A-76, however, gives the Government activity a 10 percent cost advantage, which more than makes up for this bias, but Government winners still pay more for their labor. Accentuating the problem even more is that personnel cuts made during

the A-76 efficiency review by in-house activities usually affect the most junior employees and senior employees in high pay steps remain. A new contractor would not have employees with such seniority.

The Service Contract Act/Civil Service wage disparity is not restricted to blue-collar wages. We were told by the Manpower Office at Keesler Air Force Base that the Service Contract Act minimum wage for a word processing specialist, for example, was set at \$4.50/hour while the Civil Service wage was \$6.50/hour for the same job.

#### Quick To Hire and Fire

Contractors respond quickly to fluctuations in personnel needs, hiring expeditiously when it becomes obvious that additional manpower is needed and releasing employees when manpower levels are too high. They also deal more quickly with problem employees; Pan American gives its Bangor employees a maximum of 2 months to improve or leave when poor performance is noted. All of the contractors with whom we spoke emphasized that their ability to release poor performers quickly not only relieved them of the tremendous load of carrying such workers but also had a very positive effect on the rest of the work force who see by example the results of poor performance. In-house winners, on the other hand, told us that they find it exceedingly difficult to remove a poor performer, that it takes an inordinate amount of the supervisor's time, and that it frequently results in a series of appeals that can last for months. They complain that other employees perceive that it is possible to exploit the system, and that their productivity is consequently lower than that of contractor employees.

In-house activities find that it is also very difficult to keep positions filled because of long hiring lead times. Fort Sheridan told us that it had six vacancies for most of last year in its 23-position audiovisual



shop. PWC Pensacola has had to resort to borrowing craftsmen from Base Maintenance Shops to keep its Family Housing Maintenance Shop fully staffed. Camp Lejeune has not been able to fill vacancies any faster after competition, despite its dependence on fewer maintenance positions for the same work load.

It appears that contractors are aware of their ability to quickly adjust staffing to work load and are willing to take a greater amount of risk in preparing their bids than are in-house activities.

## 3. RECOMMENDATIONS FOR HELPING IN-HOUSE WINNERS

Most in-house winners are extremely well motivated and well attuned to the operating details of their activities. The operations they manage are not only efficiently organized, but they are also highly productive with impressively qualified workers. In some areas, however, in-house winners remain at a disadvantage by having to conform to external constraints that do not exist for contractors.

Most of the contractor-specific approaches discussed in Chapter 2 ought to be examined by the Military Services for applicability to in-house activities. The use of overtime and part-time labor, for example, has been demonstrated by contractors to be cost-effective, yet both are discouraged or at least are not encouraged by the Services. Simple procedures for supplying common items to in-house activities have been implemented with COPARS (Contractor-Operated Parts Store), COCESS (Contractor-Operated Civil Engineering Supply Store), and GOCESS (Government-Operated Civil Engineering Supply Store). However, those procedures seem to stress achieving lower parts costs often at the expense of worker delays, and they are not in use at many installations. More responsive vehicle and equipment maintenance (such as after-hours routine maintenance), which could prove to be highly cost-effective, was not observed at locations with in-house winners.

The problems of wage differences between Government and contract workers and the tedious process to hire and fire Government employees are caused not only by a very elaborate civilian personnel management system but are typically required by law. Contracting-out is a subject not warmly embraced by many of the members of Congress, and OSD should continue to solicit their

support to modify the Civil Service system to make in-house employees' wages and tenures more like those in the private sector, thus preventing the loss of more jobs to contractors.

Other items that handicap in-house winners and prevent them from becoming as efficient as contractors who use the same PWS are described in the following sections.

#### BUDGET FLUCTUATIONS

Contractors that win CA competitions sign contracts with the Government that guarantee them predetermined payments if work is satisfactorily completed (all of the contracts we observed were fixed-price, and several had incentive fees). An in-house winner, on the other hand, does not have the luxury of a guaranteed budget and frequently faces fund reallocations when other installation activities experience shortfalls or surpluses. Such fluctuations may require not only a substantial amount of management's time (to reprogram work and forecast revised spending rates) but they may also cause work to be stopped and even restarted, driving costs much higher than they would have been if the fluctuations had not occurred. We do not recommend that in-house winners be given a fixed, obligated budget as contractors are, but we do suggest that the Military Services become more aware of the difficulties experienced by CA in-house winners with such budget fluctuations and provide them with as much stability as possible.

#### VEHICLE AND EQUIPMENT PURCHASES

We found that in-house winners often base their bids on the assumption that they will be provided equipment or vehicles that they are either authorized or have arranged to obtain. Unfortunately, such items do not always materialize, and the in-house winner is forced to cope without them. For example, the in-house bid for family housing maintenance at Offutt

Air Force Base was based on the availability of rental vehicles during the peak summer work season, and the vehicles were available and used in the first year of operation under the new PWS. In the following year, however, the Base was unable to provide funds for vehicle rentals and the maintenance manager had to make do without them. In the same circumstances, a contractor could legitimately argue that the Government had caused a changed condition and could insist on a contract price adjustment; the in-house winner has no such option. We recommend to the Services that equipment and vehicle needs be carefully determined and costed during the bidding process by in-house managers and that before an in-house activity is declared the winner, a formal arrangement be made to assure that such resources will, indeed, be available.

We observed no use of available productivity investment funding by in-house winners. This was surprising since productivity-enhancing equipment was frequently acquired by audiovisual managers to offset the reduced work force. More often than not, however, the equipment was purchased after the manpower cuts had occurred, and the ability to sacrifice a position in return for purchase of an item of equipment with fast payback had already been lost. Activity managers expressed little interest in productivity funds because of the extensive justification necessary to obtain them and, in some cases, the fact that they take too much time to obtain. Most of the equipment we observed was purchased with Operations and Maintenance funding although some was leased with a buy-out option.

#### EMPLOYEE-OWNED TOOLS

In the private sector, craftsmen in trades common to family housing maintenance own the hand tools they most often use. All contractors we visited required such employees to provide their own tools as a condition of

employment. We noted that Navy and Marine Corps family housing maintenance workers also provided their own tools; Air Force employees, on the other hand, were issued tools, which were replaced when lost or damaged at no cost to the craftsman unless abuse or neglect could be demonstrated. Air Force contractors told us that they considered this to be a factor in their favor since the replacement of hand tools was an expense that they did not have to consider in their bids. Since employee tool ownership appears to be a common trade practice and since other Services have been able to incorporate the practice into their union agreements, we recommend that the Air Force consider doing the same.

The above recommendations would create a climate more favorable to in-house winners that would allow them to operate more independently and abide more fully with the terms of their PWS. By reducing the uncertainties and constraints now facing in-house activities undergoing competition, these changes should allow them to make less conservative bids and compete more keenly with contractors.

APPENDIX A  
AUDIOVISUAL SERVICES HANDBOOK

Government employees generally take a negative view of contract competition in audiovisual services. They feel that such competitions result in a contractor winning and the federal employees facing a large reduction-in-force that will leave them unemployed or working for the contractor for longer hours and lower pay. What is not considered by those employees is that over half of the contract competitions in the audiovisual services field are won by the in-house work force and those in-house winners are thriving. They have made significant changes in the way they do business; they had to so they could keep their jobs. The in-house winners are now providing audiovisual services at costs lower than they considered possible before they were forced to compete.

We visited several winners and found that many of them have developed similar approaches for reducing the costs of providing quality audiovisual products and services to their customers. These new approaches are used at many installations and are not limited to one Military Service. They condense into the following eight approaches that you, the Audiovisual Manager, can take to make your activity more productive.

- Automate and update your equipment.
- Simplify your products.
- Cross-train your workers.

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Appendices A and B are suggested texts for handbooks that we recommend be provided to audiovisual and family housing maintenance managers at installation and major command levels in the Military Services. We recommend that they be formatted as illustrated pamphlets but have included only the texts for this report.

- Extend the supervisor's span of control.
- Don't be afraid of overtime.
- Keep everything under one roof.
- Make a computer your clerk.
- Encourage self-help work.

The rest of this brochure expands on these approaches and shows how each idea has helped the winners of contract competitions.



## I. AUTOMATE AND UPDATE EQUIPMENT

### Typical Practice

In recent years, the audiovisual field has been flooded with new products, many of which automate tasks that once had to be done manually. Unfortunately, many military installations still use outdated equipment such as, for example, older photo print processors, which are slow and complicated and require a lot of time for chemical mixing and cleaning. The limited availability of funds, especially for high-value capital equipment, causes many managers to make do with less than state-of-the-art equipment.

### Winners' Actions

Winners are acutely aware of the value of a worker's time. Time spent on such indirect tasks as cleaning photo lab equipment, making test prints, or mixing chemicals is viewed as an expense that could cause the activity to lose a contract competition. Winning managers have not been afraid to spend funds to make workers more productive as long as benefits outweighed costs. Some audiovisual winners, for example, purchased high-speed color print processors, which reduced the time from dry paper to dry paper from approximately 5 minutes to 48 seconds. The new processors also require much less time to clean than the older units (2 minutes versus 1 hour) and use premixed chemicals, which save considerable mixing time and produce consistent quality prints. At Hill Air Force Base, labor-saving equipment in the photo labs included a high-speed print processor, an ultrasonic rack and tray cleaner, which virtually eliminates time spent washing such items, a modified 35 color printer that now handles both color and black-and-white prints quickly and automatically, and a computerized enlarger head that senses the correct print exposure and greatly reduces the number of test prints necessary. The Audiovisual Manager at Hill Air Force Base told us that each

of these items would pay for itself in labor savings (by increasing the photo lab's output without increasing manpower) over a very short period. At Fort Sheridan, the purchase of an automatic slide collator has saved considerable time once spent on the mundane task of separating multiple copies of slides, and an automatic slide mounter has produced similar savings. A new color slide processor has brought the cost of original slides down to 11 cents each and duplicates to 7 cents each; it also significantly reduces the cost of chemicals since it uses a fixed amount regardless of work load. The processor can process three rolls of film simultaneously, vastly increasing photo lab productivity. Computer-aided graphics systems are heavily used at Keesler Air Force Base, Fort Sheridan, and Fort Jackson.

#### Recommendation

Give serious consideration to purchasing equipment that improves productivity of audiovisual workers, particularly in the photo lab. Consider using productivity investment funds that are available in each Military Service for productivity-enhancing equipment that self-amortizes over a short period of time. To qualify for funds, an organization must be able to demonstrate quantifiable actual savings, usually in the form of reduced operating costs. Competition winners have found such purchases to be well worthwhile.

## II. SIMPLIFY YOUR PRODUCTS

### Typical Practice

Personnel in audiovisual activities provide a high level of service to their customers and are justifiably proud of their performance. Unfortunately, the level of service is sometimes higher than required and is often provided without considering cost.

### Winners' Actions

Winners have taken a long, hard look at the level of service they provide and compared it to the real needs of the customer. They have found that customers often ask for services they really don't need and that a little salesmanship can often result in a simpler, less expensive product. For example, at Keesler Air Force Base, the Audiovisual Manager spent considerable time analyzing historical production records while preparing the contract specification for competitive bidding. He found that a substantial percentage of all visual aids produced for past briefings had been high-quality multi-colored overhead transparencies. By talking with his customers, he found that many of the transparencies had been used only once or twice and that audiences to whom they were shown would have reacted as favorably to simpler single-color transparencies. Since that time, his graphics personnel have asked customers who request multicolored transparencies to consider using less complicated graphics, and they have been able to reduce the number of complex projects to an almost negligible part of their work load. Productivity, in terms of number of charts per dollar, has increased dramatically. Similarly, in illustrating training texts, Keesler Air Force Base's graphics shop has substituted simple line drawings of aircraft assemblies and subassemblies for the complex shaded isometrics that had been the norm. The new drawings convey

the same concept to students, and the time required for each drawing is reduced substantially.

Recommendation

Analyze your products from the point of view of your customer. Realize that customers often ask for work based on what they have seen in the past when they would often be satisfied with a simpler, less costly product.

### III. CROSS-TRAIN YOUR WORKERS

#### Typical Practice

Most audiovisual services employees are hired to perform work requiring a single skill: photography, graphic illustrations, and in the case of the Army, carpentry and other trades. They are not expected to perform work in other specialties. Should the work load in a single skill area become especially heavy, a mismatch can develop between the work to be performed and the worker skills available. An organization can also become highly dependent on a single individual whose skills (for example, chemical mixing or a computerized graphics operation) are unique within the work group.

#### Winners' Actions

Competition has forced audiovisual managers to look at ways of getting the most from their work forces. All the winners we visited used photographers to develop their own photographs, but that approach is not uncommon. What we did find unique was the use of photographers at Fort Sheridan to do computer graphics work when backlogs develop there -- and the photographers have adapted well to this new endeavor. While they are not tasked to conceptualize an entire presentation, they do lay out individual charts and graphs and have vastly improved the flow of work during periods of peak demand. Managers of the large graphics section at Keesler Air Force Base have engaged in a tremendous push away from specialization and told us that multiskilled illustrators can not only be moved from specialty to specialty when work loads change but that by rotating an employee between specialties, managers can more easily determine where employees excel. The employees also benefit; they develop a broad skill base and are better qualified for job progression than they would be if they specialized (this latter benefit also seems to increase the employees' interest in remaining with the organization).

Recommendation

Cross-train and rotate employees as much as possible. 'Winners' experience has shown that this approach will not only increase your ability to meet heavy demand for specialized work but will give your employees a chance to learn new skills they can use to progress.

#### IV. EXTEND SUPERVISOR'S SPAN OF CONTROL

##### Typical Practice

Audiovisual activities are typically organized in an almost identical format, and whether called Base Audiovisual Service Centers or Training and Audiovisual Support Centers, they invariably contain separate sections for graphics, film library, photo lab, and (in the Army) training devices. Where there is a section, there is a supervisor; so audiovisual activities usually have a section chief for each of the sections and, depending on size, second- and third-level supervisors as well.

##### Winners' Actions

To keep costs low during competition, winners carefully evaluated each supervisor's span of control. They frequently identified supervisory positions that could absorb more responsibility and took action to reduce the total number of supervisors accordingly. At Fort Jackson, the Training Devices and Graphics Sections were placed under a single supervisor, reducing one GS-11 position; Hill Air Force Base is combining its film library and administrative sections. Winners, under competitive pressure, are working their supervisors harder and finding that the results pay off in streamlined, more-productive organizations. (Contractors universally told us that they cut the number of supervisors to the absolute minimum.)

##### Recommendation

Examine your supervisors' spans of control. Consider reorganizing to place more supervisory responsibility in fewer positions. Winners have proven that this approach is both possible and cost-effective in the audiovisual field.



7. DON'T BE AFRAID OF OVERTIMETypical Practice

Higher management policy often discourages audiovisual and other base support managers from using overtime on a regular basis. Overtime seems to be reserved for emergency use only, and significant use of overtime is considered a sign of poor management. As a result, audiovisual managers tend to staff at a higher level so they can handle work load peaks. Activities using military personnel do not feel the same pressure to avoid overtime, but we found that much unpaid overtime of military workers is quickly offset by granting compensatory time off.

Winners' Actions

Contract winners told us that they frequently use overtime. They staff for the average work load and satisfy peaks by using paid overtime. In-service competition winners, on the other hand, use less overtime because they still feel external budgetary pressures to avoid it.

Recommendation

Audit your work load and determine whether it has periodic peaks that might indicate that a full-time position is not required. Consider eliminating the position if overtime funding can be budgeted. Solicit support from your installation finance and personnel offices in this endeavor; it could increase your productivity dramatically.

VI. KEEP EVERYTHING UNDER ONE ROOFTypical Practice

Large audiovisual activities often feel pressure from large users of their services to establish satellite graphics shops proximate to and dedicated to those users. While the customer often is satisfied with such dedicated graphics support nearby, such shops are usually inefficient since they require their own duplication equipment and seldom have a steady work load.

Winners' Actions

Winners of audiovisual services competitions have brought their graphics sections back to a single location. Keesler Air Force Base for example, had up to six satellite shops located throughout the base. Each was a customer-dedicated organization requiring its own people and equipment, and there was little interchange between the shops. Since the work load for each shop was extremely variable, one shop might be overloaded while another was in a slack period. Since competing, all of Keesler Air Force Base's graphics assets have been merged into a single location. Work is now more likely to be done more productively on productivity-enhancing equipment that was not available at dispersed locations, and the work load can be more evenly distributed among personnel with diverse skills.

Recommendation

Consolidate satellite graphics shops into a single location for better use of resources.

## VII. MAKE A COMPUTER YOUR CLERK

### Typical Practice

Audiovisual centers in a central location serve a variety of customers from different major commands (even different Services) often remote from the central shop. In addition to the problems arising from priorities and schedules, considerable clerical work is associated with the administration, scheduling, and financing of work for so many customers.

### Winners' Actions

Winners have turned to automation to streamline routine clerical work such as cost accounting for reimbursable jobs. The most impressive demonstration of this was at Fort Sheridan, where personal computers (which happen to be owned by some enthusiastic audiovisual service employees) have been programmed to store job cost data and to automatically prepare the documentation necessary to bill reimbursable customers. Bills that once took hours to compute are now done in seconds. The computers also automatically prepare reports to show performance of the entire Training and Audiovisual Support Center (TASC) in relation to its objectives, giving managers an instant picture of how the organization is performing. The TASC is also automating its film library records to improve accountability and speed up the issuance and return of audiovisual products.

### Recommendation

Consider automating some of your clerical work to reduce costs and improve responsiveness. Fast payback funding is available for purchasing equipment if dollar savings can be quantified.

# VIII. ENCOURAGE SELF-HELP WORK

## Typical Practice

Many audiovisual activities provide supplies and a working area for customers to construct briefing materials by themselves. The area usually has limited supplies, outdated and used equipment and is often dark and cramped.

## Winners' Actions

Winners have learned that when their self-help areas are equipped with up-to-date equipment, ample supplies, and a respectable work area, their customers are more inclined to produce simple transparencies and charts themselves. Combined with a policy of using the simplest possible graphics style for the job at hand (see "II. Simplify Your Products"), this action could significantly reduce the amount of graphics support requested. While this approach may appear as though the graphics work load has simply been shifted to the customer, savings are realized by eliminating the time spent by a customer in communicating needs to a graphics specialist. We saw improved self-help facilities and encouragement of self-help by all of the competition winners we visited, both contract and in-house.

## Recommendation

Encourage self-help work by customers. Provide supplies, equipment, and work areas that will make it easy for your customers to create simple graphics products.

APPENDIX B  
FAMILY HOUSING MAINTENANCE HANDBOOK

Contract competition in Family Housing Maintenance is often viewed by federal employees as an opportunity for a private contractor to take over their functions. Many believe that the private contractor will win the competition, a large reduction-in-force will occur, and they will be unemployed or be forced to work for the contractor at lower wages and for longer hours. What is not realized by those employees is that one-third of all contract competitions in family housing maintenance are won by the in-house work force and those in-house winners are thriving. They have made significant changes in the way they do business; they had to so they could keep their jobs. The in-house winners are now providing family housing maintenance at costs lower than they considered possible before they were forced to compete.

We visited several winners and found that many of them have developed similar approaches for reducing the costs of providing family housing maintenance services to their customers. These new approaches are used at many installations and are not limited to one Military Service. They condense into the following eight approaches that you, the Family Housing Maintenance Manager, can take to make your activity more productive.

- Equip your workers.
- Use multiskilled maintenance mechanics, not specialists.
- Give your workers goals.

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Appendices A and B are suggested texts for handbooks that we recommend be provided to audiovisual and family housing maintenance managers at installation and major command levels in the Military Services. We recommend that they be formatted as illustrated pamphlets but have included only the texts for this report.

- Eliminate unnecessary work.
- Fit the skills to the job.
- Use one shop.
- Let the foremen get their hands dirty.
- Don't be afraid of overtime.
- Let computers do the paperwork.

The rest of this brochure expands on those approaches and shows how each idea has helped the winners of contract competitions.

# I. EQUIP YOUR WORKERS

## Typical Practice

Most housing maintenance shops have many more workers than vehicles, and most of their vehicles are not equipped with radios. Because the shops are forced to taxi workers from job to job, another worker must drive the vehicle and considerable time is lost to waiting for rides. To make matters worse, without their own vehicles, workers who find themselves without the necessary part or tool for a job have to call for transportation to the shop to get the needed part. Thus, a single job could conceivably tie up two workers for four one-way trips!

## Winners' Actions

Winners are acutely aware of the value of a worker in time. Labor costs are the predominant part of a contractor and an in-house winner's total operating budget, and managers devote a significant portion of their efforts to making sure that they get the most out of every worker. At Camp LeJeune, the family housing maintenance operation has been vastly streamlined by communications and vehicle acquisition. When a trouble call is received in the Family Housing Office, a job ticket is written at the trouble desk and is simultaneously transmitted to an automated ticket-writer in the Maintenance Shop. There, it is received by a dispatcher and, if it is for high-priority work, it can be immediately radioed to a mechanic. Since each mechanic has both a radio and a personally-assigned truck stocked with parts and tools, the mechanic may proceed directly to the job site and complete the work without having to return to the shop.

Winners feel that vehicles and radios are the keys to maximizing productivity, reducing the size of the work force, and winning competitions. The cost of acquiring these items is quickly offset by the tremendous increase in productivity.



Recommendation

Obtain productivity-enhancing equipment, especially vehicles and radio communication devices, for your workers. Your workers are your major investment; make further, smaller investments that will pay for themselves in improved worker productivity. Consider the use of productivity investment funds such as the Air Force's FASCAP, the Army's QRIP and the like to provide the investment dollars necessary.

## II. USE MULTISKILLED MAINTENANCE MECHANICS, NOT SPECIALISTS

### Typical Practice

Many family housing maintenance workers are still hired to perform tasks in a single trade, such as carpentry, plumbing, or electrical, and are not expected to perform tasks in other specialties. If the work load in one trade area becomes especially heavy, a mismatch can develop between the work to be performed and the worker skills available. An organization can also become dependent on those individuals whose skills are unique within the work group.

### Winners' Actions

Winners are heavily staffed with general-purpose maintenance mechanics who perform a variety of housing maintenance and repair tasks ranging from simple carpentry and painting through electrical and mechanical work. When coupled with other productivity-enhancing ideas, such as the use of dedicated vehicles and radio communication, the availability of multiskilled workers allows housing maintenance managers to complete more service calls while sending fewer workers on each job and completing more tasks per trip than would otherwise be possible. With multiskilled workers, the number of supervisors can be reduced since organizational grouping by trades is no longer necessary. Before competition, the 23-person family housing maintenance shop at Keesler Air Force Base had five supervisors to oversee individual trades. The current shop, operated by a contractor, now has 19 employees but only one supervisor. Keesler Air Force Base's manpower team views the failure of the in-house competitor to consider multiskilled workers as the main reason for the loss of the competition to a contractor. Every in-house winner we contacted now places greater dependence on multiskilled workers.

Recommendation

Use multiskilled maintenance mechanics whenever possible. Multiskilled workers give management the flexibility it needs to keep a maintenance work force at peak productivity. They also provide the appropriate skill level for the many family housing maintenance tasks that do not require a more highly trained worker.

### III. GIVE YOUR WORKERS GOALS

#### Typical Practice

The most important challenge facing base operations support managers is to obtain a positive internal commitment from the workers to do their work quickly and well. All too often, workers in support activities feel far removed from the base's mission, and because they have no clear-cut goals, they have little motivation for doing their best work.

#### Winners' Actions

At Camp LeJeune, the family housing maintenance competition was won by the in-service work force, which had to operate under an indefinite quantity or "open ended" contract. Both government and contractors prepared their bids by developing a cost per unit for each type of work included in the contract. When the in-house work force won, it became apparent that a cost accounting system would have to be established to collect the workers' costs and charge them to the proper category of work.

The workers were each given a copy of the new time standards (see Figure B-1) and told that they were expected to complete any job they were assigned within the standard time. They were also told that the cost-accounting system could accumulate results by employee so that an employee's performance could be compared with the standards.

The result has been overwhelming. The workers have adopted the standards as goals to exceed, and they have done so at an impressive rate. They seem to welcome the existence of a goal to work toward, and both morale and productivity in the family housing maintenance shop are quite high.

#### Recommendation

Establish worker goals in your organization; they may be time standards, productivity targets, cost limits, or level of customer

satisfaction. It appears that organizations that concentrate on such goals and hold individual workers accountable to them are more productive and secure a higher level of employee morale and loyalty.

FIGURE B-1. FAMILY HOUSING MAINTENANCE TIME STANDARDS  
CAMP LEJEUNE

| CONTRACT<br>LINE NO. | DESCRIPTION               | UNITS | AVG.<br>TIME<br>ALLOW-MIN. | CONTRACT<br>LINE NO. | DESCRIPTION                | UNITS | AVG.<br>TIME<br>ALLOW-MIN. |
|----------------------|---------------------------|-------|----------------------------|----------------------|----------------------------|-------|----------------------------|
| 01                   | Ext. Walls                | SF    | 7                          | 28                   | Bird/Animal/Fest Remv.     | C     | 75                         |
| 02                   | Int. Walls & Ceilings     | SF    | 8                          | 29                   | Tenant Not Home (TNH)      | C     | 5                          |
| 03                   | Wallpaper                 | ST    | 14                         | 30                   | Refrigerators/Ranges       | C     | 54                         |
| 04                   | Conc. Floors or Subfloor  | SF    | 23                         | 31                   | Other Appliances           | C     | 54                         |
| 05                   | Fin. Hardwood Flooring    | SF    | 13                         | 32                   | Elec. System               | C     | 43                         |
| 06                   | Carpet - Install          | ST    | 3                          | 33                   | Plumb. Syst. Repair        | C     | 36                         |
| 07                   | Carpet - Clean            | ST    | 2                          | 34                   | Plumb. Fint. Repl.         | F     | 163                        |
| 08                   | Lia/Cat/Vinyl Tile        | CF    | 6                          | 35                   | Heating System, Rept.      | C     | 28                         |
| 09                   | Fixture Sealant           | LF    | 2                          | 36                   | A/C Syst. Rept.            | C     | 42                         |
| 10                   | Int. Door & Frame         | C     | 57                         | 37                   | Heat Pump Rept.            | C     | 33                         |
| 11                   | Window Screen             | C     | 38                         | 38                   | AC/Heat Pump Comp. Install | F     | 341                        |
| 12                   | Screen/Storm Door         | C     | 33                         | 39                   | A/C Checkout               | C     | 70                         |
| 13                   | Ext. Door & Frame         | C     | 73                         | 40                   | Heating Syst. PM           | DU    | 76                         |
| 14                   | Window and Frame          | C     | 53                         | 41                   | Heat Pump Checkout         | C     | 42                         |
| 15                   | Reglase Window/Door       | SF    | 32                         | 42                   | Filters                    | DU    | 11                         |
| 16                   | Screening                 | SF    | 3                          | 43                   | Shrubs                     | A     | 43                         |
| 17                   | Roofing                   | SF    | 4                          | 44                   | Lawns                      | A     | 4                          |
| 18                   | Gutter/Downspout/Clean U. | C     | 59                         | 45                   | Leaves/Pine Straw          | A     | 26                         |
| 19                   | Porchess, Garages, Etc.   | C     | 132                        | 46                   | Trees/Shrub Trim           | C     | 62                         |
| 20                   | Cabinet Repair            | C     | 16                         | 47                   | Drainage                   | CF    | 31                         |
| 21                   | Cabinet Replace           | C     | 266                        | 48                   | Tronion Control            | SF    | 2                          |
| 22                   | Lock Set                  | E     | 51                         | 49                   | Castodial Service          | E     | 1188                       |
| 23                   | Keys                      | E     | 4                          | 50                   | COOB-Renove.               | E     | 127                        |
| 24                   | House Accessories         | C     | 17                         | 51                   | Repl. Above Grd. Fuel Tank | E     | 153                        |
| 25                   | Supporting Accessories    | C     | 49                         | 52                   | Repl. Under Grd. Fuel Tank | E     | 603                        |
| 26                   | Blinds/Toes/Shades Rept.  | E     | 29                         | 53                   | Lawns                      | E     | 216                        |
| 27                   | Blinds/Toes/Shades Repl.  | E     | 34                         | 54                   | Down Time                  |       |                            |

LEGEND OF UNITS: C - Service call; SF - Square foot; ST - Square yard; LF - Linear Foot; T - Tons; E - Each;  
A - Area; CF - Cubic Yard; DU - Dwelling Unit.

#### IV. ELIMINATE UNNECESSARY WORK

##### Typical Practice

Personnel in all family housing maintenance shops that we visited provide a high level of service to their customers and are justifiably proud of their performance. Unfortunately, the level of service is sometimes higher than required and is often provided without considering cost.

##### Winners' Actions

In the past, workers at Cherry Point Marine Corps Air Station would return again and again on service calls when nobody was home. Now, after competition, they recognize the high cost of "no-show" calls and have taken the bold step of charging tenants who have scheduled appointments a fee for "tenant not home" calls. Furthermore, tenants who lock themselves out of their home or have damaged the house through negligence are now charged for maintenance services. This policy seeks to raise the tenants' awareness of their own responsibilities and to reduce the amount of unnecessary family housing maintenance work. Camp LeJeune has trained its operators on the incoming call desk to ask a tenant a series of questions when called on a problem and to request that the tenants themselves perform simple tasks such as resetting or clearing a jammed garbage disposal unit.

The Family Housing Maintenance Office at Pensacola cut its cyclic, or recurring, workload from 8.0 to 0.8 staff years when it recognized that much of the work was not worth its cost and was of low enough priority that it was not always performed. It became obvious that the schedule needed to be scaled down to a realistic level. After analyzing historical data, the 0.8 staff year figure was agreed upon. Homeowners' responsibilities were redefined to include some maintenance, such as replacing the furnace filters, and maintenance on some items was simply stopped when it was not found to be

cost-effective. For example, routine maintenance is no longer performed on hot-water heaters because it is believed to be less expensive to fix the heaters when they fail.

Recommendation

Analyze the services you provide and determine if simplified versions of them would satisfy your customers' needs and reduce the cost of your operation. Become accustomed to looking at "ordinary" jobs and asking if they can't be done better and more cost-effectively.



V. FIT THE SKILLS TO THE JOBTypical Practice

In the past, the housing maintenance work force has been structured so as to assign the most qualified worker available to a job. A family housing maintenance manager's primary concern was to provide high-quality service to customers, and the best way to do that was to use highly qualified, perhaps even overqualified workers, without much concern for cost.

Winners' Action

Many installations have reduced their operating costs by lowering the average skill level of their work force without lowering the level of service provided to the customer. In most instances, this action was taken after in-house management engineers had conducted a thorough analysis of the work performed and determined that some positions were graded at a higher level than required.

Before competition, tradesman positions in family housing maintenance at Pensacola Naval Air Station were typically classified at the WG 8 level. In preparing for competition, management determined that 85 percent of the work could be performed by workers in Grade WG 7 or lower. Consequently, all positions except one air conditioning maintenance position were downgraded. At Cherry Point MCAS and Camp LeJeune, the skill level of many family housing maintenance positions was lowered from journeyman to maintenance mechanic or helper.

Recommendation

Assign jobs to qualified workers in the lowest possible grade. This practice is more aligned with the spirit fostered by cost competitiveness than the traditional approach of assigning the most qualified worker to a job. The traditional approach is quickly becoming a luxury that an activity cannot afford in the face of competition.

VI. USE ONE SHOP: IT'S ENOUGHTypical Practice

Military bases often have two or more housing maintenance shop locations because housing is often dispersed over large areas. One shop generally serves as the central site, while the others are more limited in scope and are considered satellite shops. Satellite shops are stocked with their own parts and supplies, their own sets of shop tools and equipment, and their own staff, usually including a supervisor.

Winners' Actions

After analyzing the cost of operating satellite shops, several winners we visited decided that the added convenience of multiple locations was not cost-justifiable, particularly if one or more supervisory positions could be eliminated through consolidation. The in-house operation at Camp LeJeune, for instance, has achieved efficiencies by closing satellite shops. Before competition, the base operated a central trade shop and several emergency service shops dispersed around the installation. Several satellite shops were closed, but because of the unusually large size of the base, closing all satellite shops could not be justified. At Hill Air Force Base, two shops served housing areas on opposite ends of the base. Despite the 3-mile distance between areas, one of the shops was closed, and the base has been operating satisfactorily with a single shop for the past 5 years.

Since satellite shops are separate operating units requiring the same types of support as the central shop, savings have been realized in several different ways through consolidation. First, merging the satellite work force with the main shop gives managers a broader pool of workers for tasks and can enable the shop to operate with fewer total authorized spaces. Second, a merger can free the satellite foremen of supervisory

responsibilities, allow them to return to workman status, and enable the number of supervisory positions to be reduced with savings for the organization. Third, since supplies no longer need to be stocked in multiple locations, savings can be realized from lower total stockage levels.

One important note: the winners who had consolidated to a single shop also acquired vehicles and radios, increasing their mobility and keeping service levels high.

#### Recommendation

Consider consolidating shop locations even if existing shops are considerable distance from each other. If closing a shop would reduce the level of service, consider an alternative means of remaining responsive, such as purchasing vehicles and communication equipment (see Action #1).

## VII. LET FOREMEN GET THEIR HANDS DIRTY

### Typical Practice

Foremen are normally responsible for a range of supervisory, administrative, and personnel tasks and are rarely called upon to perform maintenance direct tasks.

### Winners' Actions

Winners work to keep supervision from being a full-time job. At Vance Air Force Base, for example, shop foremen in Civil Engineering have been replaced with "working leaders" who are considered technical supervisors. These leadmen do not concern themselves with performance ratings, employee counseling, and the like, all of which are handled by an individual higher in the organization. The manager at Vance Air Force Base claims that a lot of time spent by other organizations in supervising is not entirely necessary and that a good supervisor can oversee many more employees than the typical military organization allows. That manager believes it is unnecessary to have as many supervisors as are found in a typical Civil Engineering shop. The work leaders at Vance Air Force Base charge much of their time to direct labor and seem quite satisfied that their years of experience in a craft have not resulted in an exclusively supervisory desk job.

### Recommendation

Make use of working leaders. Allow foremen to perform direct labor by reassigning primary responsibility for personnel tasks to a supervisor at a higher level.

### VIII. DON'T BE AFRAID OF OVERTIME

#### Typical Practice

Higher management policy often discourages housing maintenance and other base support managers from using overtime on a regular basis. Overtime seems to be reserved for emergency use only, and significant use of overtime is considered a sign of poor management. As a result, housing maintenance managers tend to staff at a higher level so they can handle work load peaks. Activities using military personnel do not feel the same pressure to avoid overtime, but we found that much unpaid overtime of their military is quickly offset by granting compensatory time off.

#### Winners' Actions

Contract winners told us that they frequently use overtime. They staff for the average work load and satisfy peaks by using paid overtime. In-service competition winners, on the other hand, use less overtime because they still feel external budgetary pressures to avoid it.

#### Recommendation

Audit your work load and determine whether it has periodic peaks that might indicate that a full-time position is not required. Consider eliminating the position if overtime funding can be budgeted. Solicit support from installation finance and personnel offices in this endeavor; it could increase your productivity dramatically.

## APPENDIX C

## HOW FUNCTIONS WERE SELECTED

Early in this project, it was necessary to select two Base Operations Support (BOS) functions to examine in detail. We reviewed the Commercial Activities (CA) Inventory that the Department of Defense (DoD) is required to maintain by Office of Management and Budget (OMB) Circular A-76<sup>1</sup> and ranked BOS functions in order of the number of positions not yet subjected to an A-76 cost comparison (see Figure C-1). Our rationale was that functions with a large number of activities that had not yet been competed under the CA program would benefit most from the findings of the study. We then examined the DoD data base of CA cost comparison study results and eliminated the following functions.

- those functions for which the cumulative in-house man-year bid was not lower than the man-year strength before competition, i.e., functions that did not produce savings of positions during in-house efficiency review;
- those that were not consistently defined across Services; for example: studies in the T301 category ranged from packaging and preservation to warehousing operation and precision instrument calibration - we could not be assured that a visit to a winning activity would produce findings applicable to all other activities in that category;
- those with a low number of CA cost comparisons (we arbitrarily set the minimum at ten comparisons): since we were interested in identifying functions that consistently produced savings, it was important that sufficient cost comparison experience be available;
- those that were primarily single-Service in nature - in intermediate aircraft maintenance, for example, all but 3 of the 36 cost comparisons in the data base were from Air Force installations.

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<sup>1</sup>U.S. Department of Defense, "Operation of Commercial and Industrial-Type Activities," DoD Instruction 4100.33, February 25, 1980.

FIGURE C-1. BOS FUNCTIONS WITH LARGE NUMBER OF UNSTUDIED POSITIONS  
A-76 STATISTICS

| CODE | DESCRIPTION                       | NAME         |          | DATE         |          | MATERIALS    |          | WEAP         |          | NET WILL<br>STUDY &<br>REPORT | NET<br>REPORT<br>ONLY | B OF SAVINGS   |                  |
|------|-----------------------------------|--------------|----------|--------------|----------|--------------|----------|--------------|----------|-------------------------------|-----------------------|----------------|------------------|
|      |                                   | NAME<br>YEAR | TOT<br>F | DATE<br>TIME | TOT<br>F | NAME<br>YEAR | TOT<br>F | DATE<br>TIME | TOT<br>F |                               |                       | ALL<br>STUDIES | COST<br>MIL DOLL |
| T001 | Supply/Weapons/Fuel               | 189          | 7        | 4            | 167      | 10           | 6        | —            | —        | 6227                          | 804                   | 18.5           | 17               |
| S002 | Buildings/Structures (Non WP)     | —            | —        | —            | 70       | 6            | 3        | 1            | 1        | 6102                          | 121                   | 22.1           | 22               |
| B724 | Guard Service                     | 606          | 13       | 7            | 211      | 16           | 7        | —            | —        | 4315                          | 2039                  | 9.5            | 9                |
| T007 | Audiovisual Service               | 140          | 3        | 2            | 30       | 7            | 7        | —            | —        | 6059                          | 3317                  | 24.7           | 23               |
| B710 | Plan Function/Transmission        | 127          | 3        | 3            | 341      | 5            | 9        | —            | —        | 4067                          | 446                   | 8.8            | 9                |
| S020 | Admin. Support Service            | —            | —        | —            | 8        | 2            | 2        | —            | —        | 3022                          | 1352                  | 22.5           | 11               |
| S091 | Family Housing Maintenance        | —            | —        | —            | 30       | 3            | 1        | 3            | 3        | 1319                          | 303                   | 4.3            | 12               |
| T007 | Maintenance of Elec. & Comm.      | 49           | 3        | 5            | —        | —            | —        | —            | —        | 1097                          | 702                   | 30.1           | 30               |
| S101 | Intermediate Aircraft Maintenance | 136          | 3        | 0            | —        | —            | —        | —            | —        | 945                           | 110                   | -6.1           | 23               |
| B720 | Air Conditioning & Refrigeration  | —            | —        | —            | 103      | 6            | 4        | —            | —        | 603                           | 10                    | -93.1          | -126             |
| B723 | Electrical Plants & System        | 7            | 1        | 1            | —        | —            | —        | —            | —        | 341                           | 30                    | 27.3           | -43              |
| S017 | Other Comm. & Electronics         | —            | —        | —            | 13       | 1            | 0        | —            | —        | 225                           | 271                   | 13.6           | 0                |
| B700 | Laundry/Dry Cleaning              | 675          | 26       | 6            | 1        | 1            | 1        | —            | —        | 266                           | 40                    | -31.5          | -21              |
| T006 | Printing & Reproduction           | —            | —        | —            | —        | —            | —        | —            | —        | 555                           | 210                   | 22.2           | 20               |
| S005 | Mail Liquid Storage Sys.          | —            | —        | —            | 45       | 6            | 1        | —            | —        | 300                           | 63                    | -10.0          | 0                |
| B710 | Other Elec. & Utilities (Mixed)   | 176          | 3        | 2            | —        | —            | —        | —            | —        | 377                           | 40                    | -1.6           | 10               |
| B706 | Installation Bus Service          | 23           | 3        | 2            | 40       | 3            | 6        | —            | —        | 637                           | 123                   | 13.7           | 23               |



- those in which less than 10 percent of all winners were in-Service organizations - since we wanted to find ideas that could be applied to in-house activities, it was important that we visit at least some in-house winners; if the vast majority of competitions were won by private contractors, we could not be assured of such an opportunity.

After the eliminations, the five top remaining functions were:

- Building/Structures Maintenance (Non-Family Housing);
- Guard Services;
- Audiovisual Services;
- Fire Protection/Prevention;
- Family Housing Maintenance.

After discussions with the Services and the Office of the Secretary of Defense (OSD), we decided to eliminate Guard Services and Fire Protection/Prevention since the Services had been asked by OSD to review those functions themselves. Building/Structures Maintenance was eliminated in favor of Family Housing Maintenance, which is similar but far more easily compared across Services.

The remaining functions, Audiovisual Services and Family Housing Maintenance, were selected for detailed study.

| REPORT DOCUMENTATION PAGE                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |                       | READ INSTRUCTIONS<br>BEFORE COMPLETING FORM                    |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------------------------------------------------|
| 1. REPORT NUMBER                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | 2. GOVT ACCESSION NO. | 3. RECIPIENT'S CATALOG NUMBER                                  |
| 4. TITLE (and Subtitle)<br>HOW WINNERS WIN: LESSONS LEARNED FROM CONTRACT<br>COMPETITION IN BASE OPERATIONS SUPPORT                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                       | 5. TYPE OF REPORT & PERIOD COVERED<br>Final                    |
| 7. AUTHOR(s)<br>John B. Handy<br>Dennis J. O'Connor                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |                       | 6. PERFORMING ORG. REPORT NUMBER<br>LWC Task W-323             |
| 9. PERFORMING ORGANIZATION NAME AND ADDRESS<br>Logistics Management Institute<br>6400 Goldsboro Road<br>Bethesda, MD 20817-5886                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |                       | 8. CONTRACT OR GRANT NUMBER(s)<br>MDA-903-81-C-0166            |
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| 20. ABSTRACT (Continue on reverse side if necessary and identify by block number)<br><br>Contract competitions in Base Operations Support have produced savings<br>averaging 27% whether a contractor or the in-house work force wins. We visited<br>eleven activities that had won competitions in the Audiovisual and Family<br>Housing Maintenance fields. The study identifies approaches taken by competi-<br>tion winners to make their operations more productive and to reduce their cost<br>of operations. The report includes recommendations to OSD and the Services on<br>how to promote similar actions in noncompeted activities and Audiovisual and |                       |                                                                |

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Family Housing Handbooks to be distributed to managers in those fields.

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## United States Senate

COMMITTEE ON  
 GOVERNMENTAL AFFAIRS  
 SUBCOMMITTEE ON  
 OVERSIGHT OF GOVERNMENT MANAGEMENT  
 WASHINGTON, D.C. 20510

### SUBCOMMITTEE

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February 12, 1985

Ms. Mary Ann Gilleece  
 Deputy Under Secretary for Acquisition  
 Management  
 Department of Defense  
 The Pentagon  
 Washington, D.C. 20301

Dear Ms. Gilleece:

Your testimony before the Oversight Subcommittee was extremely helpful in our evaluation of the Grace Commission's recommendations for procurement reform. To follow up on our January 23 hearing, we ask that you respond to these additional questions for the record.

1. As we discussed during the hearing, your general support for the Grace Commission's work seems to contradict an internal critique by the Office of the Secretary of Defense that gives little credibility to many of the Commission's recommendations. Secretary Weinberger recently agreed to provide a copy of OSD's critique of the Commission's report to the Senate Armed Services Committee. We ask that you also provide the Oversight Subcommittee a copy.
2. You indicated that the Defense Department supports all but one of the Grace Commission's procurement recommendations reviewed by the Oversight Subcommittee -- the consolidation of acquisition management within OSD. The Commission believes that consolidation is necessary to alleviate the massive duplication of effort among the Services.
  - A. While you may disagree with the Commission's recommended solution, do you believe that the duplication problem exists? If so, what should be done to address this problem?
  - B. Do you agree with Jacques Gansler's statement that the Defense Department should move towards more "jointness" -- joint planning, joint weapons systems -- since, as he points out, that's the way we fight wars?

3. You opposed the Grace Commission's reorganization recommendations on the basis that "it is false economy to attempt to 'reorganize' your way out of problems." However, Secretary Weinberger has recently established an Assistant Secretary for Spare Parts Management and an Assistant Secretary for Acquisition and Logistics.

The establishment of the Assistant Secretary of Acquisition and Logistics, which effectively implements part of the Grace Commission's reorganization recommendation, was announced less than one week after our hearing. What changed from the time of your January 23 testimony, in which you opposed the creation of an acquisition office separate from research and engineering, and the Secretary's January 29 announcement to establish such an office?

4. You stated that each of the Services buy things differently because their missions are different. While we recognize that the Services have different missions and, within each mission, that different weapons systems may be needed, we are still unclear why the Services use different buying procedures.

- A. What do you mean by different buying procedures?
- B. Why is it necessary for the Services to use different procedures?
- C. Would you cite specific circumstances under which the Services have had to use different procedures?

5. A draft report by the Center for Strategic and International Studies agrees with the Defense Department's "controlled decentralization" approach to major weapons systems acquisition, but believes that policy direction from OSD is lacking. According to the draft CSIS report, "OSD has failed to provide an overall framework and set of guidelines within which Service acquisition decisions can be supervised and coordinated. The military services thus develop weapons independently, each according to its own sense of national security priorities."

- A. Do you agree with the CSIS analysis?
- B. If so, what is being done to provide the guidance needed? If not, does your office have the authority to compel service compliance with OSD guidance?

6. You stated in your testimony that the Defense Department has taken a number of steps to improve cost estimates for major weapons systems and will continue to refine cost-estimating methodologies.
  - A. What specific steps has the Department taken to improve its cost-estimating methodologies?
  - B. Is the Department's historic inability to accurately estimate costs primarily a function of its "methodologies," or is it due to the incentives built into the system for all players -- the services, DoD, potential contractors, and congressional supporters -- to underestimate costs in order to get initial funding for their program?
  - C. If, as Norman Augustine and Jack Gansler believe, that the shared incentive to "buy in" to a program is largely the problem, how can this be remedied?
7. You indicated in your statement that the Defense Department supports the Grace Commission's recommendation to make greater use of multiyear contracting. According to recent reports, however, the Department has asked Congress to approve six new multiyear contracts for Navy and Army weapons systems in 1986, a decrease from the 12 multiyear contracts requested (nine approved) in the 1985 budget. This is reportedly the smallest number of multiyear contracts requested by the Defense Department in five years.
  - A. Why has there been a decrease in requests for multiyear contracts, especially in light of your support for its greater use?
  - B. For which programs have you requested multiyear contracts, and how much does the Defense Department expect to save for each program?
8. Joseph Wright also testified in support of the Grace Commission's recommendation to make greater use of multiyear contracting, but did not agree with the Commission that potential termination costs should go unfunded.
  - A. Does the Defense Department presently fund its termination costs in the first year of a multiyear contract? If so, is this a statutory or regulatory requirement?
  - B. From your procurement policy perspective, rather than from the Comptroller's budget perspective, do you agree with Mr. Wright's position -- that termination costs should be fully funded?

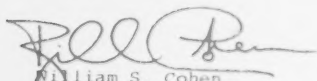
- C. What effect, if any, has requiring full funding of termination costs (which, for major weapons systems, is substantial) had on multiyear contracting by the Defense Department?
9. The Grace Commission found that the Defense Department has created a "chaotic regulatory environment" with over half a million words on thousands of different contractual issues attempting to address every possible aspect of the defense contracting process. The reason for this "undue reliance" on written regulations, according to the Commission's report, is that many government personnel involved in procurement lack the technical skills for making the professional judgments required in defense contracting.
- A. Do you agree with the Commission's finding that the Department places "undue reliance" on written regulations because of a lack of "professionalism" in the procurement workforce?
  - B. Is it realistic, as the Commission recommends, to replace the overly detailed procedures with policy statements that provide general guidance and to develop professional procurement personnel who are capable of functioning within such broadly stated policy guidelines?
  - C. What is being done to "professionalize" the defense procurement workforce?
10. Since the Grace Commission completed its report, the Federal Acquisition Regulation has been issued, which, as you know, consolidates all procurement regulations into a government-wide regulation with supplements. As pointed out at the hearing, however, the Defense Department's supplementation of the FAR has mushroomed. Not only has the Department issued a supplement to the FAR, but each of the Services has also issued a supplement to the DoD supplement, and each of the commands has issued supplements to the Service supplements. According to the American Bar Association's calculations, the supplements to the FAR are twice as long as the FAR itself.
- A. Recognizing that the FAR system is relatively new, how can we ensure that, with time, the system will improve, rather than get worse?
  - B. Do you support OMB's efforts, through the Office of Federal Procurement Policy and the Office of Information and Regulatory Affairs, to review selected implementing and supplementing acquisition regulations for unnecessary duplication and inconsistencies with the FAR?

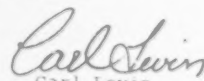


11. The Grace Commission criticized the Defense Acquisition Regulatory council for "interminable delays in implementing OSD policy-level decisions."
  - A. Have you found this to be true?
  - B. We understand that in January 1984, you called for an independent review of the DAR council's authority, structure, and methods of operation. Has that review been completed and, if so, would you provide a copy for the record?
12. Finally, on a separate but related matter, we wrote to you on December 12, 1984, and expressed our concern over the proposed implementing regulations to the Competition in Contracting Act. In our letter, we provided a list of proposed FAR provisions which we strongly believe need revision in order for the regulations to be compliant with the statute. We ask that you address each of the points raised in our letter and, as originally requested, provide us with your specific plans to revise the regulations.

Again, we appreciate your assistance in evaluating the Grace Commission's procurement recommendations, and we ask for your reply to our questions by February 28.

Sincerely,

  
William S. Cohen  
Chairman

  
Carl Levin  
Ranking Minority Member



## OFFICE OF THE UNDER SECRETARY OF DEFENSE

WASHINGTON D.C. 20301 - 3060

RESEARCH AND  
ENGINEERING  
(AM/CA)

22 MAR 1985

Honorable William S. Cohen  
Chairman, Subcommittee on  
Oversight of Government Management  
Committee on Governmental Affairs  
United States Senate  
Washington, D.C. 20510

Dear Mr. Chairman:

This is in response to your joint letter with Senator Levin dated February 12 with follow-up questions after my recent testimony regarding the findings of the President's Private Sector Survey, better known as the Grace Commission.

1. Question: As we discussed during the hearing, your general support for the Grace Commission's work seems to contradict an internal critique by the Office of the Secretary of Defense that gives little credibility to many of the Commission's recommendations. Secretary Weinberger recently agreed to provide a copy of OSD's critique of the Commission's report to the Senate Armed Services Committee. We ask that you also provide the Oversight Subcommittee a copy.

Answer: We believe you were referring to a document mentioned in an article by Michael Gordon in the 5 January issue of National Journal which referred to an internal critique forwarded to the White House before the Commission's report was released. We have been unable to locate a document which fits this description. Even if it still exists, it was apparently based on reactions to very early unofficial information which may have changed by the time the report was finalized. However, Secretary Weinberger did agree to furnish official DoD comments on some of the more significant Grace recommendations to the Senate Armed Services Committee. Those comments are presently being prepared. I have asked the Office of the Assistant Secretary of Defense (Comptroller) to provide a copy to you as soon as it is finalized.

2. Question: While you may disagree with the Commission's recommended solution, do you believe that the duplication (of effort) problem exists? If so, what should be done to address this problem?

Answer: The report on OSD has a discussion of major weapon systems acquisition on p. 139. The Task Force found that each Service maintains personnel to perform the same acquisition management functions. The way the

Task Force's conclusion is stated, the casual reader may be left with the impression that this is prima facie evidence of duplication of effort. In fact, I do not believe that the Commission intended this conclusion. If at a given time Army buys tanks, Navy buys ships, and Air Force buys aircraft, a consolidated acquisition function in OSD as discussed on pp. 141 & 142 would not be able to buy all three categories of equipment with one third of the staff. The Commission's discussion makes that clear when it is viewed in the overall context of the report.

Question: Do you agree with Jacques Gansler's statement that the Defense Department should move toward more "jointness" -- joint planning, joint weapons systems -- since, as he points out, that's the way we fight wars?

Answer: Yes, we fully agree, and Dr. Wade in the FY85 USDR&E Posture Statement has highlighted several management initiatives to improve efficiencies through enhanced joint Service programs. Examples include the formally chartered JCS board called the Joint Requirements and Management Board; the Broad-Area Surveillance Executive Committee (for Naval Warfare); the Interdiction Executive Committee; the Command, Control, and Communications Executive Committee; the DoD-wide Munitions Council; and the Strategic Defense Executive Committee.

This high-level management oversight is complemented by special joint Service efforts such as the recent Army/Air Force list of 31 joint initiatives. The oversight role of the Joint Logistics Commanders (JLC) sets the standard and pace for less-than the major systems. The JLC meets regularly to review activities and recommendations of some 50 subgroups.

We are also providing increased emphasis on joint Service testing with 30 joint test and evaluation programs since 1972. In selected technology base areas where the potential is very evident we have special management and funding procedures for joint Service research. These include the Very High Speed Integrated Circuit, the Ada high order computer language program, the computer software initiatives and microwave/millimeter wave monolithic technology efforts.

3. Question: The establishment of the Assistant Secretary of Acquisition and Logistics, which effectively implements part of the Grace Commission's reorganization recommendation, was announced less than one week after our hearing. What changed from the time of your January 23 testimony, in which you opposed the creation of an acquisition office separate from research and engineering, and the Secretary's January 29 announcement to establish such an office?

Answer: The reorganization announced by Secretary Weinberger on January 29 is vastly different from that recommended by the Grace Commission. The Weinberger Plan which basically moves the acquisition function intact from the Office of the Under Secretary for Research and Engineering to the Office of the new Assistant Secretary for Acquisition and Logistics is a realignment to allow the Department to better utilize the power it already has. By contrast, the Grace recommendation sets forth four progressively advanced alternatives

aimed at consolidating management of the entire DoD acquisition process under OSD. Among the least disruptive of these alternatives was establishment of a totally separate Under Secretary for Acquisition and they ranged all the way up to creation of a new consolidated procurement agency for all of DoD. My concern is with the scope of the reorganization proposed by the Commission. We still oppose such a sweeping move, but -- as I stated in my testimony -- we are keeping an open mind on the issue.

4. Question: Why is it necessary for the Services to use different procedures? What do you mean by different buying procedures? Would you cite specific circumstances under which the Services have had to use different procedures?

Answer: The Commission on Government Procurement recommended that "a system of government-wide coordination, and to the extent feasible, uniform procurement regulations" be promulgated. The Federal Acquisition Regulation (FAR) System was ultimately developed in response to this recommendation. The FAR system is composed of the FAR and agency supplemental regulations. Agency acquisition regulations that unnecessarily repeat, paraphrase or otherwise restate the FAR are precluded and only agency acquisition regulations necessary to implement FAR policies and procedures within the agency are permitted.

The Department of Defense (DoD) has an extensive supplement to the FAR because no other agency has the unique and large scale mission of DoD to develop and procure major military systems. The DoD FAR Supplement permits lower level supplementation in only certain circumstances set forth in DoD FAR 1.304. The Military Departments and Defense Agencies have their own supplements to the DoD FAR Supplement primarily for procedural guidance (approval levels, organizational differences, etc.) and in some few cases, to establish procedures where they have that discretion in dealing with unique segments of industry (shipbuilding, automotive, munitions, foodstuffs, etc.).

Lower level supplements deal almost exclusively with "roadmap" guidance to establish internal contracting controls. We estimate that over 80 percent of all the lower level supplements involve this type of guidance. The different missions of the Services are for the most part accommodated by the procurement policies set forth in the FAR and the DoD FAR Supplement. This is what one would expect in view of the representation from the Services and the Defense Logistics Agency (DLA) on the DAR Council. Nevertheless, some unique contracting procedures do exist but are normally limited to commodity groupings.

Some examples of unique procedures are the contractor operation of government-owned ammunition plants within the Army, master ship repair contracts used by the Navy, special internal review and approval techniques known as "Fast Track" within the Air Force, and special provisions used to acquire petroleum products within the Defense Logistics Agency. However, unique procedures such as these are a minimal part of any lower level supplement.

5. Question: According to the draft CSIS report, "OSD has failed to provide an overall framework and set of guidelines within which Service acquisition decisions can be supervised and coordinated. The Military Services thus develop weapons independently, each according to its own sense of national security priorities." Do you agree with the CSIS analysis? If so, what is being done to provide the guidance needed? If not, does your office have the authority to compel service compliance with OSD guidance?

Answer: The perception that each of the Military Services has a large voice in which systems are developed is also noted by the Grace Commission. However, the Commission goes a step further in viewing the issue as a competition for limited resources.

I disagree that policy direction from OSD is lacking. Regulations, DoD Directives, and the annual Defense Guidance provide a policy framework. The scope of this policy direction is considerably broader than that of my office by itself. My office is concerned primarily with the "how" of defense systems acquisition. It does not have either the means or the authority to direct the "what" decisions which the Grace Commission views as "entitlement" or "turf" debates and decisions and which the Center for Strategic and International Studies may also be addressing.

6. Question: What specific steps has the Department taken to improve its cost-estimating methodologies?

Answer: Developing cost estimating methodologies to support and improve our cost estimating capabilities for major weapon systems in the Department of Defense has very high priority. The OSD Cost Analysis Improvement Group (CAIG) and each of the Service cost analysis organizations carry out basic cost research as a part of their normal functions. In addition, where the scope of the research is beyond the capability or resources of the office, contract research studies are funded.

The Defense Department has established a DoD Cost Research Committee which has as its objective the coordination of all cost research performed in the DoD. It is made up of the Service Directors of Cost Analysis and the OSD Director of Cost Analysis. Semi-annual meetings are held to review and discuss policy issues related to cost research. Under the direction of this group, a coordinating committee composed of a senior analyst from each Service and OSD maintains an overview of DoD cost research. Work sponsored or performed throughout DoD is identified through surveys and other means so that suggestions can be made to make them more relevant or applicable to more than one Service and, where there is an identification of needed research not currently being performed, action can be taken to initiate it. This overview also improves the dissemination of cost research in DoD, so that duplication of efforts can be avoided, and available studies can be expanded and improved upon. With this exchange of information among the Services and OSD, the DoD is able to realize more efficient use of available cost research resources.

As part of the cost analysis improvements that are taking place, the OSD and Service independent cost analysis staff and research budgets are being increased. The OSD cost analysis staff is being increased by 33%, and the Navy staff by 25%. On December 2, 1984, the Army established a new organization, the Cost and Economic Analysis center (CEAC), reporting directly to the Army Comptroller. The CEAC mission is to produce: (1) uniform, consistent, and accurate independent estimates, and force unit and structure cost estimates; (2) to administer cost research programs; and (3) to provide direction for the Army's cost analysis career program. A total of 94 personnel spaces, 45 of which are new were provided for this mission. In addition, \$1.3 million was provided for contract cost research.

Question: Is the Department's historic inability to accurately estimate costs primarily a function of its "methodologies," or is it due to the incentives built into the system for all players -- the Services, DoD, potential contractors, and congressional supporters -- to underestimate costs in order to get initial funding for their program?

Answer: The acquisition process occurs in an inherently unstable environment which is often reflected in the development and procurement of defense programs. The high degree of instability which affects the acquisition process in general, affects the accuracy of our initial program cost estimates in a very significant way. From a purely military standpoint, for example, operational and inventory requirements for a weapon system are subject to change as a result of developments in the Soviet threat. These developments, necessitating appropriate program alterations, are often not predictable, and may occur at random intervals during the process of acquisition. It is virtually impossible to predict such changes in advance, and include them in a program's initial cost estimate. Moreover, since the development of a major system often takes more than ten years, it is possible, if not likely, that adjustments to requirements as a result of changes in the threat may occur repeatedly before a system completes production. Adjustments are necessarily made, and each time render the initial cost estimate seemingly more inaccurate.

In addition, as development proceeds, initial designs and plans may change, either because of some major unforeseen technical difficulties that prevent the meeting of performance or schedule requirements, or because the operational user decides it is essential that the equipment be modified to incorporate new operational concepts, or to exploit new technological opportunities. As with changes in threat, it is virtually impossible to predict such occurrences in advance and incorporate them into an initial program cost estimate. The lengthy period typically required for development programs increases the likelihood that numerous modifications will be introduced, each adding to variance from an initial cost estimate baseline.

The impact of budgetary fluctuations and the structure of the annual budget preparation and review process also contribute to the instability of the acquisition process. Unforeseen budget fluctuations cause a considerable number of program adjustments on an annual basis, and contribute to

unanticipated changes in program cost from initial cost estimates. To a considerable degree, the accuracy of a cost estimate also depends upon the validity of the inflation index used. When the inflation index is inaccurate, particularly when it is below the actual level experienced, program adjustments (i.e., program stretchouts) which increase the total cost of the program beyond prior estimates are often required to remain within current budget constraints. The Department experienced this sort of problem, in particular, during the latter period of the 1970's, when inflation reached much higher levels than had been anticipated by planners and programmers. During the past three years, however, as a result of an initiative contained in the Acquisition Improvement Program, the defense budget has used a more accurate model for projecting inflation upon which to build program estimates and the budget.

Since the budget is prepared and reviewed on an annual basis by numerous components within the Department of Defense, other elements within the Executive branch, as well as the Congress, it is not surprising that considerable instability is introduced as a result of our democratic approach to resource allocation. Each instance of instability has a cumulative effect, amplified over time, which results in program costs which may vary significantly from initial program estimates. While we recognize the legal requirements for, and the importance of our democratic approach to budget preparation, review, and resource allocation, we also feel that some form of biannual budget process would help to increase program stability and to reduce the impact which this process has on the accuracy of our cost estimates.

There are, of course, other elements which contribute to program instability and lead to cost estimate inaccuracy, including overoptimism in cost estimating. Nevertheless, inaccuracy in cost estimates largely stems from the instability inherent in the acquisition and budgetary processes which accumulate over the extended length of time currently required to develop and produce modern weapon systems and not from faulty estimating methodology.

Question: If, as Norman Augustine and Jack Gansler believe, that the shared incentive to "buy-in" to a program is largely the problem, how can this be remedied?

Although DoD can take advantage of the lower prices offered by contractors who buy-in, a contractor intentionally underbidding with the expectation of recovering his losses through change orders and subsequent contracts is an issue that we have addressed in our policy. Contracting officers are directed in FAR 3.501-2 to assure that in pricing change orders, losses are not recovered. Change orders are to be priced on the basis of the cost of the change only. In pricing follow-on contracts, losses incurred in predecessor contracts are unallowable. Tight administration of contracts where buy-in is suspected assures that losses are not recovered. If a buy-in



contract is terminated for the convenience of the government, the contractor's termination claim is reduced by the pro rata amount of anticipated loss in performance before final payment is made. If the contract is terminated for default in that the contractor fails to perform, possibly because it is a loss contract, the government has a right of action against the contractor for all costs involved to reprocure from another source. Further, failure to perform is sufficient basis to debar the contractor from future government contracts.

Careful review of pricing and cost estimates is an essential element of our management approach. We conduct independent cost reviews on each of our major systems in order to provide more realistic budgets, which, in turn, reduce the likelihood of buying-in. In cases where a program and independent estimates differ and the lower estimate is included in the budget, the Service Secretary is required to justify the use of a lower estimate to the Secretary of Defense. As a result of these and many other cost control related initiatives, we have reduced the rate of cost growth for our major programs from 14% in 1980 to 1% by the end of 1983.

7. Question: Why has there been a decrease in requests for multiyear contracts, especially in light of your support for its greater use? For which programs have you requested multiyear contracts, and how much does the Defense Department expect to save for each program?

Answer: In the FY 1986 budget we have requested multiyear procurement for six programs. The programs and their estimated TOA savings are the M-1 Fire Control (\$98.3M), M-1 Tank Engine (\$159.8M), T-700 Helicopter Engine (\$95.7M), LHD Ships (\$818.0M), P-3C Airframe (\$65.5M), and the MK-46 Torpedoes and Modifications (\$51.4M) for a total of almost \$1.3B in savings. We are currently evaluating other FY86 candidates, and the justification package to be submitted shortly may contain more than six. However, even if the number remains at six, which is the fewest major multiyear procurements we have requested since 1982, the amount of savings compares favorably with prior years (\$.8B in FY82; \$1.2B in FY83; \$1.5B in FY84; and \$1B in FY85).

The successful efforts of the past few years to place a significant number of our major systems in a multiyear environment has reduced the opportunities at this point to those programs just now becoming qualified for multiyear procurement.

Please be aware that our current level of implementation is quite substantial. We view this as a very successful initiative and one that will continue to be successful in the future. Congress has approved 30 of our major multiyear requests and the number of multiyear contracts currently in being is 27 (three of the 30 are essentially completed, i.e., no FY85 funding). We envision that as individual multiyear contracts are completed, others will replace them as we search for an appropriate steady-state level of implementation.

8. Question: Does the Defense Department presently fund its termination costs in the first year of a multiyear contract? If so, is this a statutory or regulatory requirement?

Answer: A MYP contract is, with one exception, funded in the same manner as all our annual production contracts. Each year of a MYP contract is funded annually in support of that year's production lot buy. The exception is the amount of funding required for economic order quantity (EOQ) materials which are bought usually in the first, second, and third years of MYP contract to support more than one annual production lot of equipment. In this instance we do fund the EOQ requirement to an amount equal to our termination liability. This procedure is done in concert with our full funding policy which reflects agreements with the Appropriation Committee of the Congress. Our DoDD 7200.4, dated Sept 6, 1983, provides direction on full funding of DoD Procurement Programs.

Question: From your procurement policy perspective, rather than from the Comptroller's budget perspective, do you agree with Mr. Wright's position -- that termination costs should be fully funded?

Answer: We feel the current policy that the Department has issued which prescribes the funding requirements for MYP programs is correct and appropriate for this type of contracting. During 1982 the Department's Council on Integrity and Management Improvement undertook a task to determine if there were viable alternatives to the current method of funding multiyear procurements. The working group concluded among other things that change(s) in funding policy which would relax requirements for extra total obligational authority in the early years of the multiyear procurement would result in a one-time short term benefit that may adversely affect program stability in the out years. Also, the Services concluded that no additional programs would be identified for MYP if the funding method were to be changed. On December 29, 1982, Deputy Secretary of Defense Carlucci agreed and approved continued use of this funding policy.

We do allow other funding approaches when justified on a case-by-case basis. On smaller programs (those not identified by a separate budget line item) the Services are permitted to include recurring cost (EOQ) in an unfunded cancellation ceiling when justified on a case-by-case basis. This was being used sparingly until the FY85 Appropriation Act ostensibly precluded its use by requiring that all economic order quantity (EOQ) advance procurement must be funded to the level of the government's liability. We have no objection to the wording except that on a case-by-case basis, we would like to have the flexibility to introduce other funding approaches for the smaller programs not identified with a separate budget line item.

Question: What effect, if any, has requiring full funding of termination costs (which, for major weapons systems, is substantial) had on multiyear contracting by the Defense Department?

Answer: To our knowledge we do not think it has had any adverse effect on either the submission or award of MYP programs. The Office of the Secretary of Defense has in each budget cycle since FY82 provided the Services up-front TOA for multiyear procurements which relieves the Services of the initial EOQ funding requirement.

Although there isn't sufficient data available to accurately estimate the size of the difference between the funding of termination cost for a given year's EOQ requirements and the expenditure funding of that EOQ requirement, we do not subscribe to the belief that it represents a substantial amount, especially when compared with the program's procurement funds required to fully fund the annual lot buy in that same fiscal year. In fact, in last year's budget, and again this year's, the savings from previously approved multiyear programs more than offsets the up-front costs of the new multiyear candidate programs.

9. Question: Do you agree with the Commission's finding that the Department places "undue reliance" on written regulations because of a lack of "professionalism" in the procurement workforce?

Answer: The Department fully supports a reduction in the amount of paperwork and directives. Under the Defense Acquisition Improvement Program, DoD Directives were thoroughly reviewed to ensure only those necessary remained. There is an ongoing program to reduce paperwork burdens on the private sector. However, many of the paperwork requirements flow from legislation and demands of oversight groups to document and support all decisions. OMB has identified over 200 reports required by Congress that it suggests be eliminated. In the contracting area, the need to account for how public money is spent will always require that adequate records and controls exist. Improving the professionalism of the procurement workforce should go hand-in-hand with allowing for increased judgment and responsibility for contracting professionals. Congressional assistance in this is critical if the tendency to institute controls on everyone for the actual or potential transgressions of a few is to be avoided. Nothing stifles initiative faster than stultifying oversight and second guessing.

Question: Is it realistic, as the Commission recommends, to replace the overly detailed procedures with policy statements that provide general guidance and to develop professional procurement personnel who are capable of functioning within such broadly stated policy guidelines?

Answer: We feel that, with an active role for the Inspector General and internal audit and management groups, it is feasible to expect proper judgments to be made if the oversight function is essentially viewed as an education process.

Question: What is being done to "professionalize" the defense procurement workforce?

Answer: We are strengthening existing procurement career management systems by:

1. Establishing career boards at the Service level to complement the existing DoD level board and to organize and involve key procurement managers in procurement workforce improvement decisions.
2. Improving procurement personnel information systems to perform workforce analysis.
3. Improving procurement career development programs to attract, develop and retain high quality personnel.
4. Improving procurement intern programs to attract highly qualified candidates.
5. Improving procurement research programs to improve the quality, effectiveness, and efficiency of the current procurement process.

We have recently contacted approximately 78 colleges and universities asking them to consider developing undergraduate and post graduate courses and degree programs which specialize in procurement, contracting, and acquisition management, to supply the employment needs of procurement positions within the Federal Government. A number of schools have already requested and we have provided, information on how to develop such programs.

DoD is working with OPM to develop competitive examinations that can be given to prospective graduates and evaluated within a short period of time (approximately 30 days) so that timely offers of employment can be extended. The examination will replace the PACE examination that was previously used to select procurement interns and is expected to be ready in October 1985. OPM will make provision for the conversion of employees hired under Schedule B authority to career or career conditional status provided they have been on board at least three months prior to the date the initial competitive exam is given.

We're presently seeking OPM endorsement of a proposed Executive Order to support the establishment or maintenance of Procurement Management Intern Programs. This E.O., if adopted, would (1) ensure that procurement interns be protected from reduction-in-forces as provided in OPM's rules, regulations, and policies; (2) ensure effective and successful continuation of existing Procurement Intern programs; (3) authorize on-campus recruitment efforts; and (4) provide for a regular intern population as a portion of new-hires.

DoD is a member of the Interagency Procurement Career Management Committee. This committee is chaired by FAI and is comprised of representatives from Federal Departments and Agencies. This committee is responsible for:

1. Identifying and analyzing procurement career management issues and concerns.
2. Prioritizing, coordinating, implementing, and evaluating interagency procurement career management plans and programs.
3. Advising and assisting interagency procurement training facilities.

4. Facilitating the transmission and exchange of information on agency procurement career management programs.

We are actively expanding training availability by certifying college courses as equivalent to DoD courses; expanding use of satellite television, and expanding use of the private sector to teach selected courses.

10. Question: Recognizing that the FAR system is relatively new, how can we ensure that, with time, the system will improve, rather than get worse?

Answer: The FAR system is being actively managed by the three procurement regulatory agencies. The Defense Acquisition Regulatory Council is undertaking a long term study effort to review the Defense Federal Acquisition Regulation Supplement (DFARS). A DFARS subcommittee is being established and, as one of its duties, it will ensure that DFARS is in compliance with the FAR.

Question: Do you support OMB's efforts, through the Office of Federal Procurement Policy and the Office of Information and Regulatory Affairs, to review selected implementing and supplementing acquisition regulations for unnecessary duplication and inconsistencies with the FAR?

Answer: No. The Department of Defense adheres to the statutory requirement that the Secretary of Defense and the Administrators of General Services Administration and the National Aeronautics and Space Administration have the responsibility and the full authority for developing and maintaining the FAR system.

11. Question: The Grace Commission criticized the Defense Acquisition Regulatory Council for "interminable delays in implementing OSD policy-level decisions." Have you found this to be true?

Answer: No, I believe the DAR council has been responsive to the needs of the acquisition community. However, it must be recognized that implementation of priority legislation (i.e., Competition in Contracting Act (CICA)) has created a case backlog and has caused delays. The DAR council has taken the necessary management steps and is in the process of reducing its backlog.

Question: We understand that in January 1984, you called for an independent review of the DAR council's authority, structure, and methods of operation. Has that review been completed and, if so, would you provide a copy for the record?

Answer: The study is still in progress. The report is due to me shortly. As soon as the report has been finalized, I will be pleased to furnish a copy to you.

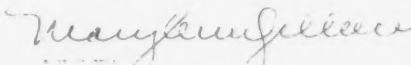
12. Question: We wrote to you on December 12, 1984, and expressed our concern over the proposed implementing regulations to the Competition in Contracting Act. In our letter, we provided a list of proposed FAR provisions which we strongly believe need revision in order for the regulations to be compliant with the statute. We ask that you address each of the points raised in our letter and, as originally requested, provide us with your specific plans to revise the regulations.

Answer: The two FAR Councils provided three comment periods on the proposed implementing regulations for the Competition in Contracting Act (CICA) due to the time constraints imposed by the effective date of the Act. Comment periods of minimal length were provided in August and October of 1984, and a final period of 60 days was provided commencing with publication of the temporary implementing regulations in the Federal Register on January 11, 1985, and ending on March 12, 1985.

It is our plan to consider and reconcile all relevant comments after the close of the final comment period. Since your comments were received after FAC 84-5 had been prepared for printing, it was decided to reconcile your comments after March 12, 1985, along with the other comments. We wish to assure you that each of your comments will receive specific consideration during this final review process. If you believe that additional dialogue would be beneficial, representatives of the two councils will be pleased to discuss specific concerns with your staff.

Again, I appreciate the opportunity to provide my views on these important issues.

Sincerely,



MARY ANN GILLEECE  
DEPUTY UNDER SECRETARY  
(ACQUISITION MANAGEMENT)

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## United States Senate

COMMITTEE ON  
 GOVERNMENTAL AFFAIRS

SUBCOMMITTEE ON  
 OVERSIGHT OF GOVERNMENT MANAGEMENT  
 WASHINGTON, D.C. 20510

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February 14, 1985

Mr. Allan W. Beres  
 Assistant Administrator for  
 Acquisition Policy  
 General Services Administration  
 Eighteenth and F Streets, N.W.  
 Washington, D.C. 20405

Dear Mr. Beres:

Your testimony before the Oversight Subcommittee was extremely helpful in our evaluation of the Grace Commission's recommendations for procurement reform. To follow up on our January 23 hearing, we ask that you respond to these additional questions for the record.

1. The Grace Commission recommends that acquisition of "common use" items, such as office equipment and supplies, should be centralized in the General Services Administration. The problem, as we discussed during the hearing, is that agencies frequently ignore GSA and buy their common-use items "off schedule." Joseph Wright agreed that agencies should be required to buy through GSA, when designated as the required source of supply, unless they have a compelling reason for not doing so.
  - A. You acknowledged in your testimony that part of the reason why agencies buy "off schedule" is that GSA lacks credibility -- agencies don't believe that GSA can provide what they need. What is being done to enhance GSA's credibility?
  - B. Another contributing factor is that some agencies don't know that GSA is the established source of supply for some "common use" items. What steps is GSA taking to increase its visibility?
  - C. Which agencies have you found are most resistant to buying through GSA? Considering that the GSA Administrator is statutorily authorized to mandate the source of supply for certain federal procurement needs, what more can be done to compel these recalcitrant agencies to buy through GSA?



- D. Is additional legislation necessary to clarify and/or augment the GSA Administrator's authority with respect to procurement and supply management? Are existing regulations adequate to establish GSA as a mandatory source of supply?
  - E. Do the regulations provide adequate controls for determining whether compelling reasons to buy "off schedule" exist? Are there penalties for not complying with GSA regulations?
  - F. Are there items for which the GSA is not the central source of supply and which currently are purchased by the individual agencies that could be purchased centrally by GSA at lower cost to the government? Does the GSA have the resources to assume greater responsibility? Would we save money in the long run if we invested more resources in GSA to expand its supply base?
2. On a separate matter, we wrote to you on December 12, 1984, and expressed our concern over the proposed implementing regulations to the Competition in Contracting Act. In our letter, we provided a list of proposed FAR provisions which we strongly believe need revision in order for regulations to be compliant with the statute. We ask that you address each of the points raised in our letter and, as originally requested, provide us with your plans to revise the regulations.

Again, we appreciate your assistance in evaluating the Grace Commission's procurement recommendations, and we ask for your reply to our questions by February 28, 1985.

Sincerely,

  
William S. Cohen  
Chairman

  
Carl Levin  
Ranking Minority Member



General  
Services  
Administration

Washington, DC 20405

MAR 14 1985

Honorable William S. Cohen  
Chairman, Subcommittee on Oversight  
of Government Management  
Committee on Governmental Affairs  
United States Senate  
Washington, DC 20510

Dear Senator Cohen:

Thank you for your letter dated February 14, 1985, in which you requested (1) our response to certain questions as a followup to our testimony on the Grace Commission's recommendations for procurement reform, and (2) our plans to revise the temporary Federal Acquisition Regulation (FAR) which implements the Competition in Contracting Act (CICA) based on comments which you previously submitted.

With respect to the first item, our response to your questions is enclosed. We very much appreciated the opportunity to testify on the Grace Commission recommendations, and hope that our views prove useful in your consideration of the various proposals. We are optimistic that with your continued support, a number of the more significant recommendations, such as, multiyear contracting authority for civilian agencies may become a reality.

With respect to the second item due to the time constraints imposed by the effective date of CICA, two periods of time were provided for comment on the proposed temporary regulation in August and October 1984. An additional period of 60 days was provided for comment after publication of the temporary regulation in the Federal Register on January 11, 1985. This final comment period closed on March 12.

It is our plan to consider and reconcile all relevant comments after this final comment period. Because your comments were received in December, subsequent to the initial comment periods and our final preparation of the temporary regulation for printing, it was decided that they should be reconciled after March 12 in conjunction with other comments which we received.

Please be assured that each of your comments will be thoroughly evaluated by the FAR Councils and appropriate action taken. When the process of reconciling the comments is concluded, we will advise you of any changes proposed as a result of your comments and the bases for the positions taken on your comments.

Please let me know if we can provide you any additional information regarding the Grace Commission's recommendations on the FAR.

Sincerely,

ALLAN W. BERES  
Assistant Administrator  
for Acquisition Policy

Enclosure

GSA RESPONSES TO FOLLOW-UP QUESTIONS  
ON GRACE COMMISSION RECOMMENDATIONS

Question 1A. You acknowledged in your testimony that part of the reason why agencies buy "off schedule" is that GSA lacks credibility--agencies don't believe that GSA can provide what they need. What is being done to enhance GSA's credibility?

Answer 1A. The credibility problems which were mentioned related to circumstances that existed in the late 1970s and 1980 timeframe. Over the past 3 years, GSA's Office of Federal Supply and Services has enhanced its credibility by adhering to strict performance standards which are monitored on a continuing basis. The indicators all are within a range reflecting a high effectiveness level in meeting our mission requirements on behalf of our federal customers. Any supply support problems which do occur are quickly handled on a case-by-case basis. The feedback we receive from our constant interaction with all departments and agencies indicates an unprecedented high level of satisfaction with the goods and services provided by GSA.

Question 1B. Another contributing factor is that some agencies don't know that GSA is the established source of supply for some "common use" items. What steps are GSA taking to increase its visibility?

Answer 1B. While GSA clearly is established as the principal procurer and supplier of common, every day items and services, it is a fact that some agencies retain procurement activities and avoid the discipline required to effectively utilize a central procurement system. This posture may change as budgets become tighter in the effort to control the cost of Government to taxpayers.

To increase its visibility and support posture, GSA over the past 3 years has intensified its marketing efforts with all federal customers. We provide regular briefings to all elements of the Department of Defense and to our civilian agency users to identify areas where we can work together to obtain greater reliance on GSA sources. Specifically, we undertook a pilot program with the Department of Commerce to identify additional ways GSA support could be beneficially utilized. Using the experience as a model, we sent additional teams of supply specialists into major customer agencies where the most significant impact could be expected. We extensively utilize user panels to advise us on customer requirements for the latest state-of-the-art equipment and supplies and on product evaluation.

We have conducted a pervasive marketing effort to call attention to the economies of buying centrally through GSA. Customer reliance increased from \$3 billion in fiscal 1981 to \$6 billion at present. This has been accomplished through training and liaison visits to headquarters and regional offices of GSA customers; issuance of customer oriented catalogs, assistance guides and other publications; telemarketing; and a new electronic inquiry system where agencies can obtain on-line information on all available products and services.

Last October in Leesburg, Virginia, we held a 3-day conference with our customer agencies to discuss ways in which we could be more effective in satisfying their requirements. In response to what we heard at Leesburg, we have initiated monthly Customer Service Forums in which we make key program officials available to respond to concerns expressed by agencies. We provide regular status reports on a number of actions that we have undertaken as a result of the Leesburg meeting. The dialogue with GSA has reached an unprecedented level that has brought praise from its customers. This heightened effort of GSA to listen carefully and respond appropriately has greatly increased the visibility and credibility of the agency. We will be advising you soon of our accomplishments to date resulting from the Leesburg Conference.

Question 1C. Which agencies have you found are most resistant to buying through GSA? Considering that the GSA Administrator is statutorily authorized to mandate the source of supply for certain federal procurement needs, what more can be done to compel these recalcitrant agencies to buy through GSA?

Answer 1C. All Executive departments and agencies use GSA centralized supply sources to some extent. These agencies also reported a substantial amount of open market procurements to the Federal Procurement Data System in FY 1983 for the types of products and services that GSA could provide. Some of these open market procurements are necessary because GSA does not currently procure all products and services required by the departments and agencies. For some products and services, GSA has made a management decision not to provide centralized supply support. In addition, when GSA provides centralized procurement coverage, our sources may be used on an optional or mandatory basis by the agencies. When GSA's procurement coverage is mandatory, some violations of the mandatory use provisions in these contracts by the agencies may occur. In some cases, agencies are granted exceptions where products covered do not meet agencies' exact requirements.

While many open market procurements by the agencies are necessary, a larger number of the open market procurements reported in FY 1983 could have been channeled through GSA for more cost-effective procurement support. More of these open market procurements were not channeled through GSA because several larger agencies with significant procurement staffs may use these staffs to procure common use items. While such staffs are necessary in the procurement of unique, mission-oriented items, using them to procure common use items, in effect, reduces the Government's leverage in the marketplace. Procuring common items in this manner may also put GSA in breach of contract position where mandatory use provisions exist in GSA contracts. Such practice also fails to take advantage of the expertise that develops over time through a centralized procurement activity.

GSA will encourage greater use of its supply sources by providing efficient supply support at attractive prices. Additionally, we have suggested that each agency Inspector General monitor agency compliance with GSA's regulations.

Question 1D. Is additional legislation necessary to clarify and/or augment the GSA Administrator's authority with respect to procurement and supply management? Are existing regulations adequate to establish GSA as a mandatory source of supply?

Answer 1D. No additional legislation or regulations are required in this area. Existing regulations are adequate to establish GSA as a mandatory source of supply for the common use items and services which we can procure cost effectively.

Question 1E. Do the regulations provide adequate controls for determining whether compelling reasons to buy "off schedule" exist? Are there penalties for not complying with GSA regulations?

Answer 1E. Regulations concerning use of GSA's central sources - Stock System, Federal Supply Schedules and Special Order Program - are adequate. These regulations establish when agencies must use GSA sources, but also permit agencies to turn to the open market in case of public exigency, where products are not managed by GSA, or where GSA-managed products will not satisfy their mission requirements. Basic responsibility for enforcement lies with individual departments and agencies through effective management, their Office of Inspector General, or other audit measures. OMB and the General Accounting Office exercise oversight on behalf of the Executive branch and the Congress. GSA's Inspector General has proposed to the President's Council on Integrity and Efficiency that Inspectors General focus on compliance with regulations concerning use of central procurement sources and make compliance a matter for A-123 vulnerability assessment.

Question 1F. Are there items for which the GSA is not the central source of supply and which currently are purchased by the individual agencies that could be purchased centrally by GSA at lower cost to the Government? Does the GSA have the resources to assume greater responsibility? Would we save money in the long run if we invested more resources in GSA to expand its supply base?

Answer 1F. There are additional items which GSA could centrally procure at lower cost to the Government. While some expansion is possible through existing programs and existing resources, a significant expansion of the GSA role in centralized procurement would require commensurate increases in contracting resources.

1100 CONNECTICUT AVENUE, N.W.  
WASHINGTON, D.C. 20036

January 22, 1985

The Honorable Ronald W. Reagan  
President of the United States  
The White House  
Washington, D.C. 20500

Dear Mr. President:

As the four former Administrators of the Office of Federal Procurement Policy, we urge you to support the continued independent function of that office and to appoint a new Administrator as soon as possible. Recent press statements suggest that the Administration is considering a proposal to reduce the stature of OFPP. We urge you not to support any proposal to abolish or to reassign its statutory functions within the Office of Management and Budget.

While we applaud and support your goal of controlling and managing Federal expenditures, we do not believe that eliminating or reducing the stature of the office responsible for oversight of the Government-wide procurement process would be a cost effective action. With the annual Federal procurement budget expected to reach \$190 billion and the public demanding rigorous accountability and performance assurances for large expenditures, OFPP should be preserved as it now stands. The Administration should act to enhance those agencies, including OFPP, which are intended to play key roles in improving the procurement process and thereby reducing the Federal deficit.

During your first term you recognized the vital importance of an independent central procurement policy office. On March 17, 1982, you signed Executive Order 12352 on Federal Procurement Reforms. To ensure efficient spending of public funds, and to make procurement more effective, you directed a series of actions by the agencies. The Director of the Office of Management and Budget, using the Office of Federal Procurement Policy as appropriate, is working with the agency heads to provide policy guidance and overall leadership of this important effort.

On December 1, 1983, you signed Public Law 98-191, The Office of Federal Procurement Policy Act Amendments of 1983, reauthorizing the Office through FY 1987. You hailed the law as "... an important component of my Administration's far-ranging efforts to reform the wasteful and inefficient procurement practices of the Federal Government."



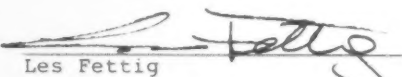
In addition, on August 11, 1983, you signed a memorandum to the heads of the agencies emphasizing the use of competition as the single most important source of innovation, efficiency, and growth in our economy. Your memorandum stated that the Administrator for Federal Procurement Policy had been directed to issue a directive on noncompetitive procurement to all departments and agencies. To quote from that memorandum: "... the unwarranted use of noncompetitive practices must and will be curtailed."

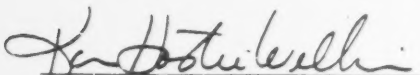
As former Administrators of OFPP, we have had the privilege of seeing OFPP in operation. We know what strides it has made and what significant reforms it has contributed to improvement of the Federal procurement process through the diligent efforts of a small cadre of dedicated professionals. Yet, much remains to be done. We cannot conscientiously stand by in silence and let this important institution be, in effect, destroyed whether by actual elimination of the Office through legislative repeal, or by erosion of its authority through failure to appoint an Administrator or assigning the OFPP tasks to the management side of the Office of Management and Budget.

Mr. President, the actions of your Administration in the first term were welcomed by the private sector and the Congress as clear indications that the vital area of procurement was receiving your personal attention, and that uncoordinated actions by the agencies would not be permitted. Now, as you begin your second term as President, it is extremely important that a new Administrator for Federal Procurement Policy be appointed as soon as possible to lead a strong, independent Office as a signal that your continued support is assured. It is our view that many more procurement dollars will be saved -- and those expended will be spent more wisely -- if OFPP plays a strong leadership role with the enthusiastic support of The White House.

Sincerely,

  
Hugh Witt

  
Les Fetting

  
Karen Hastie Williams

  
Don Sowle

(EXCERPTS FROM)

# **Toward a More Effective Defense**



**The Final Report of the CSIS  
Defense Organization Project**

Chairman: Philip A. Odeen

Vice Chairmen: Andrew J. Goodpaster  
Melvin R. Laird

February 1985



**The Center for Strategic and International Studies  
Georgetown University, Washington, D.C.**

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# Foreword

## The View from the Top

The once strong consensus for sustained increases in U.S. defense spending has eroded: as they did in the early 1970s, a large majority of Americans again believe that too much is spent on defense. To some extent, this shift may reflect the Reagan administration's first-term expansion of the defense budget, as well as the size of prospective deficits. But the decline of the defense consensus also reflects widespread frustration with the management of available defense resources.

Is the public's concern well-placed? Are there serious problems in the way the United States goes about planning, acquiring, and operating its armed forces? Or, as some maintain, has the public been misled by an overzealous media that exploits managerial lapses of only marginal significance?

In our view, the public's concern is well-founded: there are serious deficiencies in the organization and managerial procedures of the U.S. defense establishment. Yet, although concern is well-placed, its focus is too narrow and idiosyncratic. As former secretaries of defense, we are in a special position to identify the real problems in defense management; we are also able to testify about the degree to which they weaken efforts to ensure U.S. security.

The Defense Organization Project of Georgetown University's Center for Strategic and International Studies has mounted an impressive effort to survey the organizational and procedural problems of the U.S. defense establishment. The members of the Study Group, including many with whom we have worked, can speak authoritatively of the problems they describe. Their recommendations collectively have the compelling merit of both comprehensiveness and the general sharing of pain. The Study Group is correct in noting that if reform is to be most effective, it should touch all elements of the defense establishment. The Congress, the Office of the Secretary of Defense, the military departments, the joint military structures, and the defense industry all contribute to today's procedural inadequacies. All will have to implement some changes if a more effective defense establishment is to be achieved.

We also agree with the Study Group's decision not to propose radical solutions, but to opt instead for a package of **moderate** changes that build on past reform efforts. Their recommendations deserve the support of a broad-based political coalition, encompassing both political parties and all sides of the political spectrum.

The waning years of the twentieth century, and the early years of the next, will be difficult ones. Our adversaries will continue to test and probe our defenses. Increasingly, our friends are likely to look to us for our leadership and support. U.S. interests around the world will demand constant vigilance and preparedness for action. We cannot afford to waste scarce defense resources, nor can we afford to allow organizational deficiencies to impair the effectiveness of our military forces. The stakes are too great.

While each of us may disagree with one or more of the many specific recommendations contained in the Study Group's report, we are united in support for the general thrust of its proposals. We agree specifically that it is desirable to strengthen joint military institutions in order to inject a more effective integrated military viewpoint into defense planning, resource allocation procedures, and the execution of military operations. By improving the quality of military advice, stronger joint military institutions should reinforce, not usurp, the ability of civilian leaders to manage the Department of Defense.

The package of reforms proposed by the CSIS Defense Organization Project in our judgment deserves careful consideration by both the Congress and the executive. We commend it to all citizens for their review and evaluation.

**Harold Brown**  
Secretary of Defense (1977-1981)

**Clark M. Clifford**  
Secretary of Defense (1968-1969)

**Melvin R. Laird**  
Secretary of Defense (1969-1973)

**Robert S. McNamara**  
Secretary of Defense (1961-1968)

**Elliot L. Richardson**  
Secretary of Defense (1973)

**James R. Schlesinger**  
Secretary of Defense (1973-1975)

## Executive Summary

The CSIS Defense Organization Project was initiated in mid-1983 to examine proposals for improving the organization and management of the defense establishment. Nearly 70 individuals participated on the steering committee and the associated working groups. Most of us have spent a major part, if not all, of our professional careers in the defense establishment or the Congress. We have studied and debated the issues of defense organization and procedures as a group for 18 months and it is our firm conclusion that substantial improvements can be made in the effectiveness and efficiency with which the United States plans, acquires, and operates its forces.

The program set out on the pages that follow represents a pragmatic and politically feasible agenda for strengthening the organizations and procedures through which this nation establishes and executes its defense policies. Our objective has not been to reach for organizational perfection—an elusive goal at best. Rather, we have sought to assemble a set of proposals that can, if taken together, deal effectively with the most pressing problems and that can, because of their moderation and comprehensiveness, gain a critical mass of political, military, bureaucratic, and public support.

Our specific recommendations can be clustered into three areas: defense planning and military advice, resource allocation and congressional oversight, and program execution.

**Defense Planning and Military Advice.** The first set of recommendations is intended to achieve more effective planning and direction on the part of senior military and civilian managers of the Department of Defense.

★ To improve the utility and relevance of military advice presented to civilian leaders, the National Security Act should be amended to designate the chairman of the Joint Chiefs of Staff (JCS) as the principal military adviser to the president, the secretary of defense, and the National Security Council—replacing the corporate JCS in that role. The chairman should also be given the staff support necessary to provide a cross-service, professional military perspective to civilian leaders. In particular, the chairman, with the assistance of the Joint



Staff, should prepare force planning recommendations constrained by realistic projections of future resources, based upon policy and fiscal guidance issued by the secretary of defense. Service chiefs should continue to provide military advice to the president, secretary of defense, and NSC on issues of crucial importance and to the chairman and the secretaries of the military departments on all issues.

★ The role of the under secretary of defense for policy should be expanded to ensure that national defense priorities and policies are reflected in programming and budgeting decisions. This would constitute a logical extension of the under secretary's current responsibilities, which include the integration of Department of Defense plans and policies with overall national security objectives. Under our proposal, the under secretary would continue to draft the Defense Guidance, but would broaden his involvement in the program and budget review phases of the force development process. To support him in this expanded role, the under secretary's office should include an assistant secretary for each of the three major strategic missions of the Department: nuclear deterrence, North Atlantic and European defense, and regional defense.

#### **Resource Allocation and Congressional Oversight.**

Extensive improvements could be made in the way that the Department of Defense and the Congress allocate resources, as well as the way the two branches interact during this process.

★ To streamline the congressional review process and refocus legislative attention on the most important issues of national strategic priorities and resource allocation, we recommend two measures: (a) Shifting the defense budget from an annual to a biennial cycle and (b) reestablishing a clear division of labor between the defense-authorizing and the defense-appropriating committees.

★ To ensure the matching of budget and program decisions to national security objectives and priorities, the programming and budgeting phases of the department's resource allocation system should be merged. Decisions taken in such a consolidated process should be made on a program and mission basis.

★ The unified and specified commanders (CinCs) should be given a stronger institutional role in the resource allocation process and greater authority over their component commanders. Toward this end, a separate program and budget, prepared and administered by the CinCs, should be created to cover the in-theater operating costs of the forces under their command.

★ In conjunction with this enhanced role for the CinCs, OSD's ability to oversee and integrate programs related to the readiness and sustainability of forces in the field should be improved. Specifically, we recommend establishing a third under secretary of defense with broad oversight responsibilities for these programs.

**Program Execution.** We propose four measures to improve the efficient execution of defense programs.

★ To provide a sound basis for weapons development and acquisition, the Department of Defense should create a long-range capital investment plan and the military departments should establish internal contracts that set cost, performance, and schedule baselines for individual weapon programs.

★ The Department of Defense should emphasize market incentives in lieu of regulation to reduce costs and improve the effectiveness of the acquisition process. These should include: (a) promoting competition among defense contractors throughout the life of weapon programs, (b) allowing contractors increased profit margins when overall costs fall, (c) encouraging the services to reinvest cost savings toward increased quantities or improved performance of the same weapon system, (d) enhancing career opportunities and training for acquisition managers, and (e) establishing unit costs as a primary criterion in the initial design of weapons.

★ The Department of Defense should implement a systematic evaluation process to review progress made in implementing programs. This information should be the basis for subsequent planning, programming and budgeting cycles. In effect, this evaluation system would complete the allocation cycle by relating performance back to planned objectives.

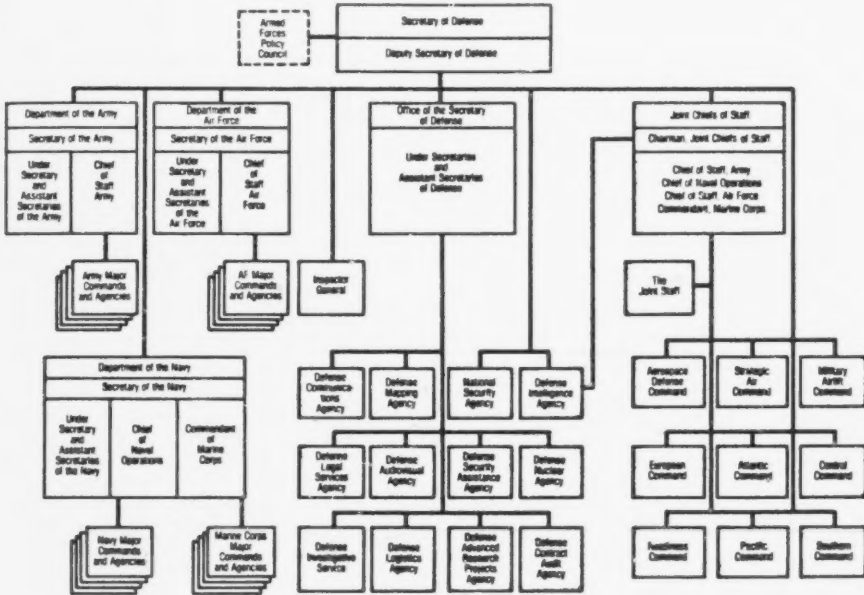
★ In the interest of increased efficiency and to reduce the tendency to micro-manage, we recommend simultaneous reductions in the size of the Office of the Secretary of Defense, the civilian and military staffs of the military departments, and the staffs of the relevant congressional committees and agencies.

We are not the first study group to recommend substantial changes in the organization and procedures of the U.S. defense establishment: we are unlikely to be the last. Yet writing in the early days of 1985, it appears that the chances for defense reform may be significantly greater than at any time since President Eisenhower's 1958 reorganization. There is a growing consensus in the Congress, in the community of defense officials and specialists, and among the American people on the need for substantial efforts to revitalize and reform the defense establishment.

It is already evident that legislation on defense organizational reform will be introduced during the 99th Congress. We urge all members to make a thorough reexamination of the existing structures and procedures of the Department of Defense and the methods used by the Congress in considering defense issues. We urge the administration to work closely with the Congress to ensure that this review results in a more effective defense establishment. And we urge all citizens to consider these issues and to communicate their views to their representatives in Washington.

Figure 1

## The Organization of the Department of Defense



**KEY:**

- Military Departments
  - Office of the Secretary of Defense
- Defense Agencies
- Organization of Joint Chiefs of Staff
- Unified & Specified Commands

# Toward a More Effective Defense

## Final Report of the CSIS Defense Organization Project

In 1958 President Dwight D. Eisenhower, a man uniquely qualified by experience and temperament to address the organization and management of the nation's military establishment, proposed major changes in the structure of the Department of Defense. He had three objectives.

First, he proposed to clarify and strengthen the authority of the secretary of defense relative to the individual military departments—army, navy, and air force—in order to grant the secretary full authority over all defense activities. This objective has been largely achieved.

Second, President Eisenhower sought to improve the quality of the military advice given to civilian leaders by granting more authority to the chairman of the Joint Chiefs of Staff and giving him full control over the Joint Staff. The Congress amended Eisenhower's proposals, limiting the chairman's authority to managing the Joint Staff on behalf of the four members of the Joint Chiefs of Staff, who are also the heads of the four military services.

Third, he sought to ensure the unity of operational command of U.S. armed forces in the field by separating the military services from the unified and specified combatant commands. In effect, he sought to clarify the division of labor between the services and the commands. The services, organized along traditional lines of air, land, and sea warfare, would perform the maintaining functions of recruiting, organizing, training, and equipping the armed forces. The unified and specified commanders-in-chief (CinCs), organized along geographic and functional lines, would operate and lead the forces in combat theaters. This division of labor was incorporated in law; nine unified and specified commands are now in existence. The commanders-in-chief, however, have never been provided with real authority in peacetime. As a consequence, their ability to perform their missions has been compromised.

In our view, this failure to complete the Department of Defense reforms that President Eisenhower proposed in 1958 is among the root causes of current problems in the U.S. defense establishment. Despite the good will, competence, and effort of the individuals who have in the past and are now leading the Department of Defense, we continue to face a broad range of problems in the management of our national security activities. It has become increasingly clear that these problems are inherent in the organizational structure and procedures within which these activities are conducted. Specifically, current weaknesses include the following:

- The current system fails to provide timely, cross-service military advice to the president, the Congress, and the secretary of defense during the planning and resource allocation process.
- The Office of the Secretary of Defense (OSD) is cast in the role of managing a system that emphasizes inputs (budget dollars, manpower, etc.) rather than programmatic outputs (capabilities to perform specific missions), and delivers service-oriented programs that are inadequately balanced by mission and theater perspectives.
- OSD and the Congress are encouraged to do too much hands-on management and too little policy direction and priority setting.
- Defense management processes are overly cumbersome and repetitive, forcing all participants—military and civilian, executive and congressional—to spend an inordinate amount of time on the details of programs at the expense of policy issues and oversight considerations.

Most of us have spent a major part, if not all, of our careers in the defense establishment or Congress. We have studied and debated these issues as a group for eighteen months and have concluded that three sets of improvements would help resolve these problems. Each set of recommendations include specific proposals for organizational and procedural reforms. We are convinced that these improvements are feasible on both substantive and political grounds.

The first set of improvements is intended to achieve more effective planning on the part of senior military and civilian managers of the Department of Defense. It would enhance particularly the utility of military advice presented to civilian leaders during the planning process. Our proposals include an expansion of the charter of the

under secretary of defense for policy and extensive changes in the responsibilities of the chairman of the Joint Chiefs of Staff.

Second, extensive improvements can be made in the way the Department of Defense and the Congress allocate resources, as well as the way the two branches interact during this process. These recommendations include shifting to a biennial budget cycle, merging the programming and budgeting portions of the resource allocation system, expanding the role of the unified and specified commanders in the programming/budgeting process, and creating a third under secretary of defense charged with the integration and oversight of the programs necessary to ensure that the armed forces are prepared to undertake and sustain combat operations.

Third, we propose a number of changes that are designed to improve the execution of the defense program. Our most extensive recommendations have to do with the weapon system acquisition process and include increased competition, more accurate cost projections, and the development of a long-range investment plan. In addition, we would enhance the role of evaluation in the Planning, Programming, and Budgeting System (PPBS) and make major changes in the accounting and reporting systems within the Department of Defense. We also propose simultaneous reductions in the size of the Office of the Secretary of Defense, the civilian and military staffs of the military departments, and the relevant congressional committees and agencies. We not only believe less staff would be warranted under the proposed new structure, but that smaller staffs would be less likely to indulge in detailed management and more likely to focus on the more important functions of oversight and policy formulation.

We believe that if these recommendations were implemented, they would have a salutary effect on the conduct of our national security affairs. In particular, we think that they would

- Promote a reorientation of the civilian leadership of the executive branch toward greater concentration on plans and priorities, the management of major programs, and the continual evaluation of current and past activities to ensure more productive performance in the future.
- Provide a more effective and broader role for military leaders in planning, programmatic, and budgetary decisions.
- Enhance the policy formulation and oversight roles of the Congress.



Because of the enormous breadth of the subject, we have organized the report in four parts, three focused on organizational changes—joint military structures, OSD, and the Congress—and a final section directed at procedural arrangements—PPBS and the weapons acquisition system. We conclude with some brief remarks concerning the current politics of defense reform.

Before looking at the details of our proposals, a brief comment on the human aspect of defense management is in order. Although better organizational structures and procedures would improve the management of the defense establishment, the most critical factor will always be the competence and experience of the people involved. Even the best-structured organization cannot work effectively with unqualified people. But the converse is also true: outdated or cumbersome organizations and procedures will handicap even the most outstanding and dedicated individuals. Thus, in the interest of a more effective defense, we support steps to facilitate the recruitment and retention of exceptional individuals for key management in the defense establishment. But we also believe it essential to strengthen defense structures in the ways described below, in order to allow these people to perform to the full extent of their capabilities. Indeed, by making their roles more productive and rewarding, these reforms would reinforce efforts to attract and retain the best minds in the defense establishment.

# IV

## Force Development and Acquisition

The Department of Defense has developed two major processes to aid the secretary of defense in integrating the plans, programs, and budgets of the individual military departments: the Planning, Programming, and Budgeting System (PPBS) and the major system acquisition process. Both processes need to be adjusted in line with the organizational changes recommended in the previous three sections to ensure that the secretary can carry out his integrative roles effectively.

### Planning, Programming, and Budgeting

PPBS is the department's formal process for planning and allocating resources. Its central purpose is to design a military strategy and force posture that can achieve the nation's strategic objectives at the least cost. The system consists of three phases. *Planning* translates the overall defense priorities established by the president and his senior advisers into guidance for force development. *Programming* develops and evaluates specific multi-year force structure alternatives on a mission-oriented basis. The product of this second phase is the Five-Year Defense Program (FYDP). *Budgeting* determines the cost of the first year of the FYDP and produces the administration's budget submission to Congress.

PPBS has not fulfilled the promise of a multi-year process that would proceed deductively from the establishment of national defense priorities through the development of specific defense programs to the formulation of each year's budget request. The model of PPBS as a series of interlocking functions, the output of one forming the input of the next, has not been realized. To meet these objectives, we believe that all three basic phases of PPBS need to be overhauled.

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## Planning

There is broad agreement that, in the words of the 1979 Defense Resource Management Study, "the first P in PPBS is silent." More precisely, the planning that takes place in the Department of Defense is not linked adequately to subsequent programming and budgeting decisions. This shortcoming has two organizational sources.

First, OSD does not adequately translate national strategic objectives into a policy framework and set of priorities to guide program development. This is not to say that OSD's strategic and policy thinking does not influence allocation decisions; it does. But rather than making an integrated contribution to the planning phase, OSD relies on detailed involvement in individual program and budget decisions to produce, inferentially, an overall military plan.

Second, joint military planning is not constrained by realistic projections of future defense budgets. Consequently, the primary JCS planning documents are fiscally unrealistic and therefore largely ignored in the programming and budgeting process. Instead, national military force planning results from loosely coordinated, parallel dialogues between OSD and each of the individual service departments. This often results in disparate plans that do not optimize the potential contribution of each military service to national strategic objectives.

**Recommendation:** Two measures would make the planning phase more meaningful:

1. The responsibilities of the under secretary of defense for policy should be expanded to ensure that program and resource decisions reflect mission-oriented planning:

2. The chairman of the JCS, with the assistance of the Joint Staff, should be charged with preparing force planning recommendations constrained by realistic estimates of available resources.

The detailed content and implications of these recommendations have already been discussed. These organizational reforms of OSD and the JCS would have substantial benefits in enhancing the quality and the relevance of defense planning, as well as in improving and expanding the contribution of cross-service military advice.

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### Programming and Budgeting

The rationale for the division of the resource allocation process into three identifiable phases rests in large part on the concept that the programming process should serve to translate security plans and priorities into specific budget requests. In practice, however, programming and budgeting have evolved into competing, rather than complementary, processes. As originally intended, the programming phase was to be the forum in which senior decision makers would evaluate alternative programs and approve a rolling FYDP. The subsequent budgeting phase would then be limited to the mechanical process of costing out the first year of the approved program in detail. Instead, the budgeting phase has developed into a separate decision-making process, in which many of the issues ostensibly decided in the programming phase are reconsidered. On issues where the secretary of defense has been heavily involved in the programming phase, major decisions usually survive the subsequent budget review. For less visible issues, however, decisions made during the programming phase are often overturned or changed significantly at budget time—even when the underlying conditions supporting the original decisions remain unchanged. This pattern of revisiting program decisions undermines the programming process and wastes much effort by senior civilian and military officials.

This problem is compounded by the fact that the Department of Defense programs funds on a different basis than it budgets them. Moreover, the link between these two processes is inadequate. Programs are developed in terms that emphasize outputs or missions such as strategic nuclear forces, tactical aircraft, or airlift. In contrast, budgets are formulated in terms of resource inputs such as military personnel, operations and maintenance, and procurement. The FYDP,

which arrays each of the major mission programs in terms of dollars and forces, provides a crosswalk between the programming and budgeting data, but it is not sufficiently flexible or responsive to translate readily between programs and budgets. As a result, it is difficult for decision makers to evaluate the longer term program implications of the budget cuts that inevitably take place toward the end of the process.

The limited ability to translate between programming and budgeting processes is exacerbated by the gaps that occur between the overall fiscal levels used to guide the preparation of defense programs and the actual size of the budgets the president proposes and the Congress eventually approves. The problem begins with the often wide differences between the fiscal guidance assumed by the Department of Defense at the beginning of the annual program cycle in the spring and the actual budget level eventually approved by the president late in the fall. Having put together a program using optimistic fiscal assumptions, the department is faced with the need to make program cuts to meet the president's final budget decision at the end of the cycle. Given the difficulty of moving between programming and budgeting, the department finds it difficult to map out the programmatic consequences of these budgetary adjustments.

**Recommendation:** The programming and budgeting phases of PPBS should be merged into a single process that retains a program and mission orientation, but simultaneously establishes relevant budget inputs.

We recommend the integration of the programming and budgeting processes in order to promote the matching of resource inputs to program outputs and the linking of both to defense objectives and missions. Under this proposal, the programming and budgeting functions would be merged at each stage of the process:

- the issuance of policy and fiscal guidance by the secretary of defense;
- the preparation of program and budget requests by the military departments and the operational commands;
- the review of those requests by OSD.

The mechanical adjustments needed to unify programming and budgeting would have to be worked out in detail. A number of approaches are possible. For example, an OSD committee in the late

1970s proposed a single cycle, in which program and budget decisions would be established in parallel review processes. Whatever review process is instituted, the merger of programming and budgeting would also require restructuring the budget into program or mission terms, as well as developing improved means of translating program categories into traditional appropriation categories for presentation to Congress.

Merging the two phases would make the system more efficient by minimizing the need to revisit decisions. It would also provide greater constancy to program decisions. Moreover, merging programming and budgeting should help to alleviate the problems caused by large gaps between the budget mark used to design the program and the eventual budget submitted to Congress. A variety of factors makes it inevitable that presidents delay final decisions on the size of the defense budget until shortly before submitting the budget to Congress; consolidating programming and budgeting would accommodate this requirement. With budget inputs integrated into program categories, defense decision makers would be better able to evaluate the ramifications of late adjustments in the defense budget total. This, in turn, would reduce the likelihood that these budgetary changes would unbalance the program.

Merging the two phases would not be risk free. There is some possibility that programming would be submerged if the urgency of making short-term budget decisions came to dominate the entire process. In fact, to a degree the present system already suffers from this problem. We believe that the proposed merger of programming and budgeting would help balance the short-term focus of the current process by ensuring that decision makers have a better understanding of the program implications of their budget decisions.

If a biennial budget cycle is adopted, the PPBS process should be revamped to take advantage of the additional time made available in the non-budget year. During that year, the department's focus could be directed at long-range planning and programming (years 3 through 15). As is discussed in the section on weapons acquisition below, the centerpiece would be a long-term resource plan.

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## Evaluation

Evaluation is the orphan function in the current resource allocation process. Insufficient attention has been devoted to program evaluation



and to the review and feedback procedures necessary for such evaluations. In theory, PPBS should be a circular process with financial and performance data from one year's cycle serving as the planning base for the early phases of the next year's process. In practice, however, PPBS essentially starts fresh each year. Little systematic attention is given to the evaluation of past program decisions. Major weapon programs that have high congressional visibility are sometimes an exception to this generalization, because their cost and performance data tend to be monitored more closely. But PPBS has never included an explicit and comprehensive system for measuring and reporting progress in implementing approved programs.

Further, the department's accounting base is inadequate to support effective evaluation. Department of Defense financial reports provide a mass of data, but the financial information in these reports is often inconsistent, incomplete, and untimely. The source of many of these shortcomings is the department's reliance on accounting systems that operate almost exclusively on an obligational basis. Under this system, an economic event is measured when the resources are "obligated," that is when contracts are awarded or orders placed—an emphasis that is understandable in terms of the department's fiduciary responsibilities. Obligation-based data, however, inhibit the evaluation of program effectiveness and management performance by focusing attention on the time of the commitment, with little monitoring of the actual delivery or the effective use of the resources acquired. For example, the entire cost of a navy ship may be obligated in one year, but the ship may not be completed for as many as seven years. An obligation-based accounting system records the bulk of the cost in that first year and does not monitor how those resources are expended over the seven-year building cycle.

The absence of sophisticated management information systems also impedes effective program evaluation. There are some areas, such as personnel recruiting and retention, in which the department has developed effective management information systems, but there are numerous others in which such systems are either incomplete or do not exist. The lack of integrated performance data is particularly severe with respect to combat readiness, as the 1978 Steadman Report pointed out. Although there are many detailed reports on the operational readiness and warfighting capabilities of U.S. combat forces, these reports focus on unit, rather than theater or command-wide, capabilities. Not only are these reports conducted and routed through service channels, but the services use differing standards to measure unit readiness. Accordingly, both operational commanders



and senior policymakers lack comprehensive measures of the readiness of the forces upon which they would rely in time of war.

**Recommendation:** The Department of Defense should implement an explicit evaluation process that systematically reviews progress made in implementing programs and cycles that information into subsequent planning, programming, and budgeting phases. In effect, this evaluation system would constitute a fourth phase of PPBS, completing the allocation cycle by linking objectives to performance standards. Specifically, we recommend three measures:

1. Conducting programming, budgeting, and execution processes within a unified accounting structure;
2. Supplementing the current obligation-based accounting system with reporting on an accrual basis;
3. Improving management information systems to enable decision makers to evaluate progress toward identified objectives.

*Unified Accounting Structure.* The value of merging programming and budgeting would be enhanced by parallel improvements in the accounting system. The new system should record the use of resources in the same manner as they are planned, programmed, and budgeted. In this way, the reported status of current programs would provide valuable performance and cost information for decisions in the planning cycle for future years.

*Accrual Accounting.* The Department of Defense should also update and improve its accounting system to provide complete, accurate, and timely cost information to decision makers. The accounting system should record the use of resources on an accrual, as well as an obligational, basis. Accounting on an accrual basis (recording resources as they are expended) is a key factor in improving the evaluation system, in that it would provide the basis for judging the impact of spending on a program in terms of its output.

*Management Information Systems.* Finally, the Department of Defense should adopt more comprehensive management information systems in order to assess performance in crucial areas such as equipment maintenance and combat readiness. Since these systems would have

to be tailored individually to specific program needs, the details of their operation and implementation are beyond the scope of this report

The comptroller-general has prepared a comprehensive and thoughtful program to enhance financial management in the government covering all three areas discussed above; it will be released in the near future. We believe that it deserves sympathetic review by both the executive and legislative branches.

## **Weapons Acquisition**

Problems in the weapon acquisition process have received more critical attention over the past few years than any other defense issue. Delays in deliveries of new weapons, cost overruns, and questions about the performance of new systems have given rise to congressional investigations, banner headlines, and much soul-searching in recent administrations. We have attempted to look beyond the recent debates over such issues as warranties and operational testing to illuminate the underlying causes that so often lead to rising costs, schedule delays, and disappointing performance. We have identified three basic determinants of problems in the weapon acquisition process:

1. an inadequate planning and selection process,
2. instability in programs and budgets,
3. the lack of natural market incentives throughout the acquisition process.

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### **Planning and Selection Process**

To ensure that the United States develops the proper mix of weapon systems to support its defense priorities, OSD must define the links between national strategy and specific acquisition decisions. OSD's attraction to managing the details of individual weapon programs, however, has diverted its attention from establishing this crucial linkage. With the exception of such high profile areas as strategic nuclear forces, OSD has failed to provide an overall framework and set of guidelines within which service acquisition decisions can be

supervised and coordinated. The military services thus develop weapons independently, each according to its own sense of national priorities. As a consequence, many weapons are procured without a defined relationship to overall national strategic objectives and priorities. While weapons of questionable value that fulfill service priorities sometimes assume a life of their own, often surviving despite strong evidence of inadequate performance or excessive costs, weapons needed for national purposes that do not fit a service's core function tend to be developed slowly, if at all.

The Department of Defense has been often unable to procure planned numbers and types of weapon systems within planned budgets. Some of this cost growth can be attributed to the uncertainties inherent in building weapons that are on the frontiers of modern technology, and some is the result of the instabilities in programs and budgets described below. A substantial portion, however, is attributable to specific deficiencies within the acquisition process itself.

Estimating the cost of high technology systems involves enormous uncertainty. An entire range of estimates is possible depending on the desired confidence level. The current process, however, is structured in such a way that defense contractors, the military departments, and the Congress all have incentives to keep initial cost estimates at the low end of the possible range. Defense contractors have an incentive to submit optimistically low bids in order to secure weapon development and production contracts. If costs have in fact been underestimated, they can then usually rely on later changes in engineering and design specifications to negotiate the final price upward. The Pentagon's reliance on sole-source contracts for most major systems provides an hospitable environment for this practice of "buying in" to new programs. Contractors typically compete with each other only in the initial phases of the acquisition cycle. Once a development contract has been awarded, there is generally no further competition throughout the life of the program. As the only producer of what may be a crucial weapon system, the contractor then has substantial leverage in negotiating the ultimate price and other terms of the new system.

Nor is it usually in the short-term interest of the military services to question low bids. The services themselves are competing for scarce defense dollars and wish to minimize their apparent demands. When a service is seeking initial funding for a new weapon system, the lower the estimated cost of that system, the more receptive the secretary of defense, the Office of Management and Budget, the president, and the Congress are likely to be. By the time these initial cost estimates have

been proven to be too low, the weapon is likely to have acquired its own constituency—including the administration, which has an interest in demonstrating the validity of its decision, and those legislators in whose districts the weapon and its various components are to be built. Accordingly, although cost growth frequently results in the stretch out of development and production schedules, the cancellation of a program after a decision to enter full-scale development is unusual, regardless of cost growth.

**Recommendation:** The Department of Defense should develop an overall, long-range capital investment plan to provide a sound basis for force development and acquisition. In this context, the department will require more accurate cost projections for major weapon systems.

*Long-Range Investment Plan.* To coordinate the acquisition strategies of the individual military services, we recommend that the Department of Defense prepare an integrated, long-range investment plan that allocates resources in broad categories to mission areas. Because major system development takes eight to twelve years, this plan should be based on a 15-year assessment of the nature and scope of the military threat. To be useful, it should be constrained by a realistic estimate of the resources likely to be available for defense. Under our proposal, the under secretary of defense for policy and the director of program analyses and evaluation would prepare this plan for review and approval by the secretary of defense. Once the initial plan had been prepared, the primary task would be to prepare an annual update that would take into account shifts in the assessment of threats posed to the nation, new technological opportunities, and altered judgments of fiscal constraints on future defense budgets.

The long-range investment plan would not be an extension of the FYDP. It would be less detailed and would be used by defense decision makers as a planning guide, not a definitive decision document. The value of the capital investment plan would be twofold. First, it would integrate long-range service acquisition plans, providing a road map in each major mission area that linked national strategic objectives with major acquisition programs. Second, it would serve to highlight the aggregate demand on the overall resources that the Department of Defense is likely to have available over the next 15 years, forcing early assessments of the tradeoffs that competing commitments to major weapon systems make necessary. In this

manner, the plan would help focus greater attention on the costs of burdening the budget with too many major program starts.

All three military departments have experimented with such long-term resource plans, with the army using the approach most extensively. Reportedly, these experiments have been most useful in shaping planning priorities. Their integration into a department-wide planning tool is a logical and necessary next step.

*Accurate Cost Projections.* To be useful as a planning tool, however, the long-range investment plan must be based on accurate projections of the costs of major weapon systems. Accordingly, we recommend that in preparing the plan the under secretary for policy rely more heavily on independent cost estimates, rather than the projections of the services and defense contractors. In addition, given the inherent uncertainty in cost estimating, each major program should be provided with adequate management reserves. There is a danger that providing such reserves at the start of a program may actually encourage cost growth. We believe, however, that there is legitimate uncertainty in projecting the costs of major weapons and that it is short-sighted not to make allowances for cost growth. More specifically, we believe that the provision of budgetary reserves for increases in the cost of new weapons, or "planning wedges" as they are sometimes called, could help to control excessive program starts and, thus, minimize costly stretch-outs.

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### Program and Budget Stability

The acquisition process suffers greatly from what one observer has called its "ubiquitous turbulence": shifting funding levels, lengthening production schedules, frequent personnel transfers, and rapidly changing design specifications. Continual revisions in a program divert management attention from the task at hand, encourage inefficiency, discourage capital investment by contractors, and undermine employee motivation and morale. Three major factors are at the source of much of the turbulence.

First, congressional procedures that result in the detailed review of every program every year, together with the legislators' attention to the concerns of particular constituents, have produced strong incentives and multiple opportunities for micro-management by the legislature.

Annual congressional alteration of hundreds of procurement and research and development line items produce year-to-year uncertainties for program managers and defense contractors. The inevitable result is less efficient management, higher unit costs, and longer production schedules. Congressional preoccupation with the details of programs has also served to short circuit its constitutional responsibility to help formulate overall national strategies and purposes, and to conduct effective oversight of the execution of national security policy by the executive branch.

Second, there is the problem of too many new program starts. As explained above, the Department of Defense systematically underestimates the costs of new weapon programs. At the same time, the department's five-year defense plan is consistently optimistic regarding the aggregate spending levels that Congress will approve in the outyears. Congress contributes to this problem by focusing primarily on the up-coming budget year, largely ignoring longer range issues. Congress insists that the Department of Defense establish viable long-term plans, but then undermines their effectiveness by reviewing the budget in detail only for the immediate fiscal year. As a consequence, more weapon programs enter development than budgets in future years will be able to sustain. Moreover, since new programs are terminated only rarely, even weapons of marginal promise limp from one budget year to the next. In short, too many competitors for too few dollars produce continual stretch-outs in the development and production schedules of ongoing programs. Combined with stretch-outs brought on by cost growth within individual programs, the result is a slower than desirable pace of modernization and constantly escalating program and unit costs.

Third, the bureaus and officials that oversee research and development in both OSD and the military departments too frequently revise the technical requirements that drive weapon programs either to incorporate new advances in technology or to account for altered assessments of potential adversaries' capabilities. This so-called "requirements creep" is a natural outgrowth of laudable efforts to deploy the most modern and capable weapon systems. Nevertheless, the unsystematic nature of this process results in constant design revisions that contribute to higher unit costs and slowed development and production schedules, as well as reduced reliability and operability.



**Recommendation:** In addition to the long-range investment plan described above, we recommend two supporting measures to increase the stability of programs. First and most important, Congress should review the defense budget request on a biennial basis. Second, the military services should be required to establish internal contracts that set cost, performance, and schedule baselines for their weapon programs, including reserves that are commensurate with the uncertainties entailed.

*Biennial Budgeting.* Our proposal for a biennial budget process was discussed in the section on congressional reform. A biennial budget cycle would introduce greater stability to weapon programs by reducing the year-to-year uncertainty about budget levels. Biennial budgets would also allow contractors to establish more efficient production rates with correspondingly lower unit costs. Finally, biennial budgets would permit both the Department of Defense and the Congress to devote more time to the long-term implications of weapon development and procurement decisions.

*Baselining.* To obtain greater stability, it is also essential that the services restrain themselves from readjusting the parameters and specifications of their weapon programs too frequently. Toward that end, we recommend that all services adopt the baselining technique the air force developed for the B-1B program and has used successfully for other major weapons. Under this system, each service would establish an internal "contract" for each major weapon program, specifying the desired performance parameters as well as the annual funding levels, quantities, and production schedule. Once established, these contracts could not be altered, except as a result of an explicit review and approval by the service secretary. In this way, both the service itself and OSD's research and engineering office would be discouraged from encumbering the program with frequent design changes. The improved performance expected from a desired design change would have to be significant enough to merit raising the issue with the service secretary. In more marginal cases, it is likely that proposed changes would be clustered together and incorporated into the program only as a new version of the system were developed.



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### Creation of Natural Market Incentives

In spite of the fact that defense is not normally considered a regulated industry, it is important to recognize the very high degree of regulation present. Moreover, this regulation is unique in that the regulator is also the dominant buyer. With so much involvement on the part of the buyer in the operation of the supplier, it is difficult for the free market to operate. Nevertheless, there is a strong tendency within the department, the Congress, and the defense industry to act as if free market conditions exist and rely on the invisible hand of the market to produce economic efficiency.

Perhaps the dominant characteristic of the weapon acquisition process is the lack of competition for most of the dollars involved. When the Department of Defense initiates competitive bidding for the development of a new generation of a weapon system, there is usually fierce rivalry among several large firms. But once the selection for initial development is complete, the rest of the program—product development, testing, and eventual production—is normally conducted in a sole-source environment. Thus, unlike the commercial marketplace, the buyer—the government—has no alternative sellers or competing products to meet its need. Essentially, the contractor has achieved a monopoly position. The Department of Defense is dependent on that producer for crucial equipment and thus lacks leverage in setting the terms of subsequent contracts. This distinction between competition for an initial award and the lack of competition during the execution of a program is the primary difference between the defense market and the commercial world.

Besides this lack of a continuous alternative, the normal profit incentive for cost reduction is minimized in defense contracting. Under the current system, the department typically negotiates annual production contracts based upon the previous year's costs plus a profit margin that remains relatively constant. Accordingly, the contractor is often rewarded when costs rise, since the profit of the follow-on contract is computed on a larger cost base. With such incentives, there is little pressure to hold down future labor and material costs because the contractor can usually pass these costs directly on to the department.

The lack of natural market incentives on the industry's side is matched by similar disincentives within the Department of Defense. The military services have little incentive to reduce unit costs. Because the number of systems to be procured is usually fixed, any savings from reductions in unit costs usually end up as budget cuts in the next fiscal

cycle. Moreover, the military personnel system does not provide adequate incentives for officers to seek assignments in acquisition management. Most military officers recognize that there are limited opportunities for enhancing their careers in the acquisition world. Accordingly, many seek to avoid such duty and those who do serve in acquisition management positions seldom seek further assignments. The result is that the overall experience levels and training of uniformed personnel in acquisition is inadequate.

Finally, unlike the practice in the commercial sector, cost is rarely a primary criterion in the design of weapons; it is derived instead from performance criteria. The normal Department of Defense procedure is to optimize weapon designs for maximum performance with limited attention to unit cost. The department then seeks industry bids on those specifications, awarding the contract to the lowest responsible bidder. This practice discourages employing advanced technology to lower costs. It also makes it difficult to determine systematically the marginal costs of specific improvements in performance, thus complicating assessments of the tradeoffs between fewer highly capable weapons and a greater number of somewhat less capable weapons.

**Recommendations:** The Department of Defense should seek to create market incentives to reduce costs in the defense acquisition process. Specifically, we recommend

1. promoting competition among defense contractors throughout the life of a weapon program,
2. allowing contractors to increase profit margins when costs fall,
3. encouraging the services to reinvest cost savings toward increased quantities or improved performance of the same weapon system,
4. enhancing career opportunities and training for acquisition managers,
5. establishing unit cost as a primary criterion in the initial design of weapons.

**Continuous Competition.** In the commercial world, the maintenance of some form of alternative—either between two suppliers for the same product or between two products for the same mission—is the norm. The Department of Defense should seek to institute a similar incentive

structure for defense contractors by promoting, where possible, competition throughout all phases of a program's development and production. Competition throughout the development and production phases of a weapon program would provide incentives for lower costs and greater performance. It would also reduce the opportunities for contractors to "buy in" to a sole-source contract with an optimistically low bid.

***Profit Incentives.*** The Department of Defense should adjust the future profit margins of defense contractors to reward cost underruns and punish cost overruns. We propose that the negotiated profit margin be adjusted up or down based upon the contractor's prior-year performance in meeting the planned unit costs for its product. If costs exceed those specified in the contract, the profit margin on the next contract would be reduced. Conversely, if costs fall below those in the planned budget, the profit margin would be increased. In this way, both the government and the supplier would benefit from lower costs.

***Service Incentives.*** The incentives for the military services to achieve lower unit costs could be improved by a practice of allowing them to buy greater quantities or improve the performance of a particular system if its unit costs fell below planned funding levels. In other words, a portion of any cost savings would be returned to the services for the acquisition of greater military capabilities.

***Career Incentives.*** In order to attract and retain high quality officers in acquisition management, the military services should improve the possibilities for career advancement in the acquisition area. At the same time, the amount and level of training for acquisition managers should be enhanced. Perhaps most important, managing weapon programs well should be rewarded with promotions, including promotion to flag rank.

***Design to Cost.*** In order to ensure that the department and defense contractors take advantage of technological advances to reduce cost as well as maximize performance, unit cost should be made a primary design criterion of each weapon system. Contractors would be required to meet these cost limitations, just as they are expected to meet specified performance parameters. Indeed, the inclusion of cost as a primary design parameter would promote explicit tradeoffs between improved performance and lower unit costs with larger numbers deployed.

# V

## Prospects for Reform

We are not the first Study Group to recommend substantial changes in the organization and procedures of the U.S. defense establishment; we are unlikely to be the last. Yet, writing in the early days of 1985, it appears that the chances for defense reform may be significantly greater than at any time since President Eisenhower's 1958 reorganization. There is a growing consensus in the Congress, in the community of defense officials and specialists, and among the American people supporting the need for substantial efforts to revitalize and reform the defense establishment.

The program that we have set out in this document represents a pragmatic and politically feasible agenda for strengthening the organizations and procedures through which the nation establishes and executes its defense policies. Our objective has not been to reach for organizational perfection, which is an elusive goal at best. Rather, we have sought to assemble a set of proposals that can, if taken together, deal effectively with the most pressing problems and that can, because of their moderation and comprehensiveness, gain a critical mass of political, military, bureaucratic, and public support.

It is already evident that defense organizational reform legislation will be introduced in the first session of the 99th Congress. We urge all members to re-examine thoroughly the existing structures and procedures of the Department of Defense and the methods used by the Congress in considering defense issues. We urge the administration to work closely with the Congress in this effort to ensure that this review results in a more effective defense establishment. And we urge all citizens to consider these issues and to communicate their views to their representatives in Washington.

## Working Group on Weapons Acquisition

Chair: Jacques S. Gansler

Robert J. Art  
Norman R. Augustine  
Les Aspin  
Dale W. Church  
Eugene J. D'Ambrosio  
Edwin A. Deagle  
John J. Ford  
J. Ronald Fox

Rowland G. Freeman  
Dave McCurdy  
Joseph F. Shea  
Marvin Stern  
George H. Sylvester  
Robert F. Trimble  
Robert H. Wertheim  
R. James Woolsey

Rapporteur: Janne E. Nolan

The Working Group on Weapons Acquisition identified four major objectives for acquisition reform: improved mechanisms for making long-range resource allocations and weapon system choices; increased program and budget stability; greater emphasis on natural market incentives to reduce unit costs; and increased attention to the health of the defense industrial base.

To achieve these objectives, the working group believes that the roles of the major institutions involved in the acquisition process must be adjusted.

- Joint Military Structures. The chairman of the JCS, the Joint Staff, and the unified and specified commanders should play a greater role in the establishment of long-range resource plans and weapon requirements.
- Office of the Secretary of Defense. OSD should concentrate on ensuring the linkage between overall national security priorities and acquisition decisions, while refraining from detailed involvement in program management.
- Military Departments. The military departments should be held responsible for managing the development, procurement, training, and support of forces.
- Congress. The Congress should adopt a multi-year budget cycle, disengage itself from detailed line-item reviews, and play a stronger role in setting national strategic priorities.

**APPENDIX B****Defense Organization Project  
Steering Committee**

**Philip A. Odeen** is regional managing partner of Coopers & Lybrand's Management Consulting Group in the mid-Atlantic area. Mr. Odeen has had extensive experience in the government, including service on the National Security Council staff under Henry A. Kissinger, and in the Department of Defense, where he served as principal deputy assistant secretary for systems analysis. Mr. Odeen is a former vice president of the Wilson Sporting Goods Company. He is active with a number of charitable and educational organizations.

**Andrew J. Goodpaster** is currently president of the Institute for Defense Analyses. His distinguished career includes service as defense liaison officer and staff secretary to President Dwight D. Eisenhower; assistant to the chairman of the Joint Chiefs of Staff; director of the Joint Staff, Supreme Allied Commander, Europe; and superintendent of the U.S. Military Academy. General Goodpaster's awards include the U.S. Medal of Freedom and numerous military decorations.

**Melvin R. Laird**, a member of Congress for many years, served as secretary of defense from 1969 to 1973 and later as counselor to the president for domestic affairs. He is currently senior counselor for national and international affairs for the Reader's Digest Association, Inc.

**Les Aspin**, newly elected chairman of the House Armed Services Committee, has represented southeast Wisconsin since 1970. He attended Yale, Oxford, and MIT, where he earned a Ph.D. in Economics. Prior to his congressional service, Aspin worked in the Department of Defense.

**Norman R. Augustine** is vice president of Martin Marietta Aerospace and president of its Denver subsidiary. He has served as president of the American Institute of Aeronautics and Astronautics, president of the Association of the United States Army, and chairman of the Defense Science Board. He has held several positions in the Department of Defense, including assistant secretary of the army (research and development) and under secretary of the Army.

**Barry M. Blechman** is president of Defense Forecasts, Inc. and a senior fellow at Georgetown University's Center for Strategic and International Studies. He served in the government as assistant director of the Arms Control and Disarmament Agency. He has published extensively on issues of foreign and defense policies.

**William K. Brehm** has served in numerous positions in the Department of Defense, including assistant secretary of defense for manpower and reserve affairs and assistant secretary of defense for legislative affairs. He is currently president and chairman of the board of the SRA Corporation in Arlington, Virginia.



**William S. Cohen** has represented Maine in the U.S. Senate since 1978. He is currently a member of the Armed Services and Governmental Affairs Committees and chairs the Subcommittee on Seapower and Force Projection. Senator Cohen recently received the Non-Commissioned Officers' Association's L. Mendel Rivers Award for service to military personnel.

**Edwin A. Deagle**, a former army officer, is currently director of international relations at the Rockefeller Foundation. Deagle's positions in the public sector include service at the Congressional Budget Office and on the National Security Council staff.

**Robert F. Ellsworth** has had a distinguished career including service as deputy secretary of defense (1975-77), assistant secretary of defense (1974-75), U.S. ambassador to NATO (1969-71), and assistant to the president (1969). He represented the 3rd district of Kansas in the U.S. Congress from 1961 through 1967.

**Jacques S. Gansler** is vice president and director of The Analytic Sciences Corporation. He has held executive positions both in government and in the private sector, including deputy assistant secretary of defense for materiel acquisition. Gansler is the author of *The Defense Industry*, published by MIT Press.

**Newt Gingrich** represents west central Georgia in the U.S. House of Representatives and is a member of the military reform caucus. He is currently developing an alternative defense posture to help the country survive, with an emphasis on bolstering the national guard and services, and bringing free market principles to bear in Pentagon procurement.

**Samuel P. Huntington** is Eaton Professor of the Science of Government and director of the Center for International Affairs at Harvard University. A founder of the quarterly journal *Foreign Policy*, he served as its coeditor until 1977. He has worked in the government on the National Security Council staff.

**David C. Jones** was a member of the Joint Chiefs of Staff for eight years, serving under four presidents. General Jones served as chief of staff of the air force from 1974 to 1978 and chairman of the Joint Chiefs of Staff from 1978 to 1982.

**Nancy Landon Kassebaum** was elected to the U.S. Senate from Kansas in 1978. She serves on the Foreign Relations, Budget, and Commerce Committees, chairs Subcommittees on Aviation and African Affairs, and has been Senate chair of the military reform caucus.

**William J. Lynn**, a research associate at the Center for Strategic and International Studies, is executive director of the Defense Organization Project. An attorney, Lynn has worked previously at the U.S. Mission to NATO in Brussels.

**Edward C. Meyer** retired from the U.S. Army in June 1983 after serving for four years as its chief of staff. General Meyer's army service included several positions on the Joint Staff and with Supreme Headquarters, Allied Powers, Europe. General Meyer also served as a commander during the Korean and Vietnam Wars, leading all combat elements from platoon to division.

**Sam Nunn** is the ranking Democrat on the Senate Armed Services Committee. He also serves on the Intelligence Committee, the Permanent Subcommittee on Investigations



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of the Government Affairs Committee, and the Small Business Committee. In 1984, Senator Nunn was elected to represent Georgia for a third term.

**William J. Perry** is managing partner of H&O Technology Partners. Prior to that he was executive vice president of Hambrecht & Quist Inc. Dr. Perry served as under secretary of defense for research and engineering from 1977 to 1981.

**Donald B. Rice** has been president of The Rand Corporation since April 1972. Dr. Rice has had an active career in the public and private sectors, including service as assistant director of the U.S. Office of Management and Budget.

**Alice M. Rivlin** is director of the economic studies program at the Brookings Institution. Prior to rejoining Brookings in 1983, Dr. Rivlin served for eight years as the first director of the Congressional Budget Office. She has written extensively on the U.S. economy, the budget, and public decision making, is a MacArthur Foundation fellow, and was Harvard's Godkin lecturer in 1984.

**Thomas B. Ross** is senior vice president for corporate affairs of the RCA Corporation. He served as assistant secretary of defense for public affairs from 1977 to 1981. A newspaperman for more than 20 years, Mr. Ross was Washington bureau chief of the *Chicago Sun-Times* from 1970 to 1977.

**William Y. Smith** served in the U.S. Air Force for 35 years before retiring in 1983. General Smith served as assistant to the chairman of the Joint Chiefs of Staff and held other positions in the Office of the Joint Chiefs of Staff and the Office of the Secretary of Defense; he also served as deputy commander of the U.S. European Command.

**Samuel S. Stratton** is a senior member of the House Armed Services Committee and chairman of its Procurement and Military Nuclear Systems Subcommittee. A member of Congress since 1950, Mr. Stratton is recognized as a leading congressional expert on defense matters. He served in the U.S. Navy during World War II.

**Harry S. Train** is executive vice president of Future of Hampton Roads, Inc. Admiral Train has served as commander-in-chief of the United States Atlantic Command, as NATO's Supreme Allied Commander-Atlantic, as commander-in-chief of the United States Atlantic Fleet, and as commander of the U.S. Sixth Fleet.

**Togo D. West, Jr.** is a partner in the New York and Washington, D.C. law firm of Patterson, Belknap, Webb and Tyler. He was general counsel to the Department of Defense from 1977 to 1981.

**John P. White** is chairman of the board and chief executive officer of the INTERACTIVE Systems Corporation. He served as deputy director of the Office of Management and Budget and assistant secretary of defense for manpower, reserve affairs, and logistics during the late 1970s.

**R. James Woolsey** is a partner in Shea & Gardner and counsel of CSIS. Among other positions in the public sector, Mr. Woolsey has served as under secretary of the navy, a member of the START delegation, and general counsel to the Senate Armed Services Committee.



The Defense Organization Project of Georgetown University's Center for Strategic and International Studies has mounted an impressive effort to survey the organizational and procedural problems of the U.S. defense establishment . . . . Their recommendations deserve the support of a broad-based political coalition, encompassing both political parties and all sides of the political spectrum. . . .

While each of us may disagree with one or more of the many specific recommendations contained in the Study Group's report, we are united in support for the general thrust of its proposals. The package of reforms proposed by the CSIS Defense Organization Project in our judgment deserves careful consideration by the Congress and the Executive. We commend it to all citizens for their review and evaluation.

**Harold Brown**  
Secretary of Defense (1977-1981)

**Robert S. McNamara**  
Secretary of Defense (1961-1968)

**Clark M. Clifford**  
Secretary of Defense (1968-1969)

**Elliot L. Richardson**  
Secretary of Defense (1973)

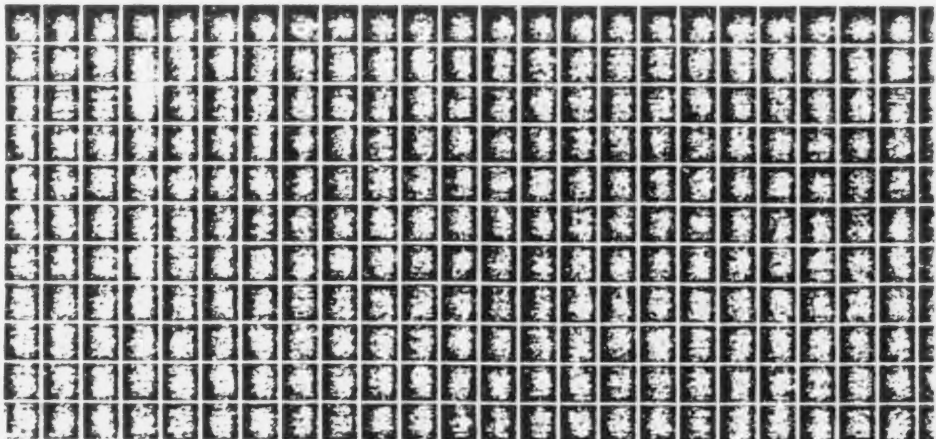
**Melvin R. Laird**  
Secretary of Defense (1969-1973)

**James R. Schlesinger**  
Secretary of Defense (1973-1975)



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MEMORANDUM FOR DAVID STOCKMAN, DIRECTOR, FROM DONALD E. SOWLE, OFPP/  
DOUGLAS H. GINSBURG, OIRA: EXECUTIVE ORDER NO. 12291, "FEDERAL REGULATION," OF FEBRUARY 17, 1981

The purposes of this memorandum are twofold: First, to request a further exemption for procurement regulations from certain sections of Executive Order No. 12291. Second, to request your concurrence in requiring agencies to submit certain implementing and supplementing acquisition regulations and associated procedures to OMB for review. Review of these regulations and associated procedures will provide the mechanism to monitor implementation of the Federal Acquisition Regulation (FAR). It will also signal to the agencies that unnecessary or duplicative procurement regulations, which impose additional burdens on the public, will not be permitted. Instances of issuance of unnecessary and duplicative regulations have already been found in the Department of Health and Human Services and the Department of Defense.

Section 8(b) of Executive Order No. 12291 authorizes the Director to exempt any class or category of regulations from any or all requirements of the Order. In accordance with that authority, we are requesting a further extension of the exemption for procurement regulations from Sections 3 and 4 of Executive Order No. 12291.

The exemption would:

- a. Apply to all agency procurement regulations, except:
  - (1) Those pertaining to ADP and telecommunications equipment;
  - (2) Those regulations implementing and supplementing:
    - (a) Federal Acquisition Regulation Subpart 15.6, "Source Selection;" and
    - (b) Federal Acquisition Regulation Subpart 32.5, "Progress Payments Based on Costs."

- (3) Those regulations implementing and supplementing:
  - (a) The Competition in Contracting Act of 1984 (P.L. 98-369);
  - (b) The Defense Procurement Reform Act of 1984 (Title XII, P.L. 98-525); and
  - (c) The Small Business and Federal Procurement Competition Enhancement Act of 1984 (P.L. 98-577).

b. Permit the Director, as provided in Sections 3(b) and 6(a) of Executive Order No. 12291, to require compliance with the Order on an *ad hoc* basis (i.e., the exemption could be withdrawn for specific issues).

(c) Expire on October 31, 1985, at which time the matter would be reviewed again.

The exemption from Section 5, "Regulatory Agendas," will not be extended. Therefore, beginning with the April 1985 Agenda, all agencies must include procurement entries in their regulatory agenda. The agencies are required, pursuant to the recently added Section 22 of the Office of Federal Procurement Policy Act (41 USC 420), to publish procurement regulations in the *Federal Register* for public comment before they can take effect. These publication requirements parallel those in the Administrative Procedure Act. Publication of procurement items in the Regulatory Agenda is a logical adjunct to the *Federal Register* publication requirement and will provide the public with notice of items being considered for regulatory action. Although most civilian agencies already include procurement entries in their regulatory agenda, we believe that the Department of Defense will object to this requirement.

We also request your concurrence and signature on a memorandum requiring that the agency implementing and supplementing regulations for which the exemption from Executive Order No. 12291 is being withdrawn be submitted for review by OMB (OIRA) and OFPP. Authority for the review is contained in Sections 3(i) and 6(a) of Executive Order No. 12291 and in the Office of Federal Procurement Policy Act (Public Law 93-400, as amended; 41 USC 401 *et seq.*).

Agencies are being required to submit any agency regulation and associated procedures having an impact or bearing upon the contractor-Government relationship, implementing the Competition in Contracting Act of 1984 (Title VII, Division B, Public Law 98-369), the Defense Procurement Reform Act of 1984 (Title XII, Public Law 98-525), the Small Business and Federal Procurement Enhancement Act of 1984 (Public Law 98-577), and Subparts 15.6 and 32.5 of the FAR. These areas have been chosen as timely for review because they involve recently enacted procurement legislation now being implemented in the FAR and by the agencies.

The principal purpose of the FAR was to streamline, simplify, and reduce the proliferation of regulations and to present "one face" to the private sector; thereby, making it easier and less costly to do business with the Government. The FAR was published as a final rule in the *Federal Register* on September 19, 1983, and became effective on April 1, 1984. Republication of the FAR and agency implementing regu-

lations at that time, with the impact analyses required by the Executive Order, would have duplicated previous efforts, caused unjustifiable additional paperwork, and delayed and disrupted implementation of the FAR. Such an effort would have been totally out of proportion to any conceivable, resultant Government or public benefit.

Now that the FAR is effective and the FAR System has been established, OMB (OIRA) and OFPP plan to review selected sections of agency implementing and supplementing acquisition regulations and associated procedures, starting with the initial "data call." The review will determine, specifically, whether the regulations: (1) are limited to what is essential to implement Government-wide policies and procedures within the agencies and to such additional policies and procedures as required to satisfy the unique needs of the agency; (2) unnecessarily repeat, paraphrase, or otherwise restate material contained in the FAR or higher-level agency acquisition regulations; or (3) conflict with or are inconsistent with the FAR. Subsequent "data calls," issued periodically, will permit an orderly and ongoing program of regulatory review to be accomplished.

Withdrawal at this time of the exemption for review of certain agency regulations furthers the general philosophy of Executive Order No. 12291 to "... reduce the burdens of existing and future regulations, increase agency accountability for regulatory actions, provide for Presidential oversight of the regulatory process, minimize duplication and conflict of regulations, and ensure will-reasoned regulations. . . ." Withdrawal of the exemption and review of the regulations will not be unduly disruptive to the agencies and is necessary to control and reduce proliferation of agency acquisition regulations and to ensure compliance with the basic concepts of the FAR System. The review will also identify any previously undisclosed areas that impose information collection or recordkeeping burdens on those doing business with the Government.

We recommend that you sign the memorandum extending the exemption and the memorandum requiring the submission of agency regulations and associated procedures for review.

[From the Washington Post, Feb. 3, 1985]

#### BELIEVING IN GRACE

(By George F. Will)

Remember the dressing-down King Arthur gave Guinevere in the nunnery? It was stern, but not more so than Steven Kelman's analysis of the Grace Commission report on government "cost control."

The Commission gave Ronald Reagan the idea that there are 2,478 ways of eliminating "waste" and thereby saving, in just three years, \$424 billion. Hence Reagan's belief that the budget deficit can be tamed by "growth and Grace"—by economic growth and by eliminating only things that no one wants.

The initial press release trumpeted: "Commission Discloses \$424 Billion in Waste." But much of what it chose to call waste is just policy—the reasonably efficient operation of programs the commission considers unnecessary. (Hence the commission's assertion that \$424 billion could be saved in three years "without in any way harming necessary social welfare programs.") Fourteen percent of the \$424 billion (\$58 billion) was to come (in years 2001-3) from cutting federal, civilian and military pensions.

Now, in the winter issue of *The Public Interest*—no liberal journal—Kelman, of Harvard's Kennedy School of Government, argues that the horror stories about waste "are almost always gross exaggerations." The commission specialized in such stories as:

"The Pentagon has been buying screws, available in any hardware store for 3 cents, for \$91 each."

Make your blood boil? Simmer down.

Pentagon acquisition rules stipulate that "overhead" expenses be allocated to each shipment at some fixed proportion of the value of the product. If the value is \$5 million, the corporation might be entitled to add, say, 20 percent (\$1 million) for overhead. Overhead includes costs above materials, machines and labor—costs of everything from legal departments to company headquarters.

The Pentagon orders many kinds of parts simultaneously. As an approved accounting convenience, many contractors allocate overhead on an "item" rather than "value" basis. Kelman illustrates this with an example of a \$20 million order for

10,000 parts, some of which have a direct cost of \$25,000 each and others of 4 cents each.

"Instead of apportioning the \$1 million total overhead such that the \$25,000 part gets a lot and the 4-cent part a little, the computer printout will allocate \$100 to each part. This produces a charge to the government of \$25,100 for the expensive part and \$100.94 for the cheap one."

The Grace Commission charged that in "comparison to a private sector company, managing comparable building space, the General Services Administration employs 17 times as many people and spends about 14 times as much on total management costs." Outraged? Do not be.

The commission committed two howlers. It compared GSA with an actual insurance company managing 10,000 buildings—but the company really managed only 1,000. Also, the Commission said the company employed just 200 management professionals under contract. Kelman found that the company actually had 200 management firms under contract.

The commission charged: "The Veterans Administration spends \$61,250 per bed to construct nursing homes—almost four times the \$16,000 per-bed cost of a major private-sector nursing home operator." Kelman found that the commission averaged the cost of six VA homes, and the average was radically inflated by including a West Virginia home, the cost of which included a related facility that was part of a whole medical facility built adjacent to it. The costs of three of the other five homes were significantly raised because of site difficulties. The sites were dictated by the VA policy of locating homes near VA hospitals.

Furthermore, VA costs are raised by government policies of providing certain quality features (such as balconies for the rooms) and giving preference to American-made products and minority and small businesses. The wisdom of such policies is debatable; but the policies are not "waste."

Kelman demolishes several other Grace horror stories, but mere facts are no match for the desire to believe politically convenient things. The Grace report, and especially the President's love of it, demonstrates the extraordinary things people will believe in order to avoid facing unpleasant facts, such as the fact that the deficit cannot be substantially shrunk painlessly.

Do you really believe the government is paying \$110 for a 4-cent diode, and that if it would just quit doing such things it could save \$424 billion in three years? Remember in "Through the Looking Glass," when Alice says it is impossible to believe impossible things and the Queen (who should be the chairman of the Council of Economic Advisers) says: Fiddlesticks, I've believed as many as six impossible things before breakfast? The Queen was no slouch, but not in the league with the Grace Commission and its believers.



## The Grace Commission: How much waste in government?

STEVEN KELMAN

THERE ARE FEW BELIEFS more deeply embedded in the popular consciousness than that government wastes a lot of money. Seymour Martin Lipset and William Schneider, in their book *The Confidence Gap*, report that in surveys asking people how much of each tax dollar they think the federal government wastes, the median response is 48¢. Lipset and Schneider argue that the paradox of simultaneous public support for tax cuts, and for maintaining or increasing spending in all major categories of government programs, is explained by the perception that waste in government is so rampant that there can be big spending reductions without service rollbacks.

Last January the President's Private Sector Survey on Cost Control (generally known as the "Grace Commission" after its head, J. Peter Grace, Chief Executive Officer of W.R. Grace & Co.), delivered its final reports. The Grace Commission recruited over 2,000 corporate executives to scrutinize the government. Announcing the report, Peter Grace told the press that President Reagan had asked him to look at government agencies as if considering a merger or takeover. "The President's private sector survey would not acquire the government" was the conclusion, he stated. No wonder. He found that, over a three-year period, a total of \$424 billion in sav-

ings could be obtained from controlling waste, "without weakening America's needed defense build-up and without in any way harming necessary social welfare programs." These were stupendous numbers, almost enough to eliminate federal deficits.

But they were not uncontroversial. With the perspective of someone interested in how government can be managed better, I spent time examining some specific allegations of waste the Grace Commission made in areas where, first, there is general agreement—public and governmental—that the activity being undertaken is worthwhile, and second, there are examples of the private sector producing the same output, so that the relative costs to government and to the private sector can be compared. The Grace Commission issued 48 reports and made a now-notorious 2,478 recommendations, so it was obviously impossible to examine any significant percentage. But in the press packet accompanying the Grace Commission report, there was a chart entitled "Ten Random Examples of Bureaucratic Absurdity" (which was picked up in the *New York Times* story on the Commission), and I examined those ten.<sup>1</sup> Also, I examined recommendations the Commission made involving the General Services Administration (GSA) and the Veterans Administration (VA), because the responsibilities of both agencies include tasks very similar to ones private firms undertake.

#### The case of the \$91 screw

(1) *"The Pentagon has been buying screws, available in any hardware store for 3 cents, for \$91 each."*

There have been many widely publicized examples of the apparently outrageous prices paid for spare parts for weapons—\$110 for a 4¢ diode, \$9,609 for a 12¢ Allen wrench, and \$1,118 for a plastic cap for a navigator's seat.

One has reason to doubt these stories, even before further investigation, on strictly logical grounds. To suggest that defense contractors could routinely charge the government \$110 for something they got for a few pennies is to suggest that the defense contracting business is the easiest avenue to unearned fortune since the invention of plunder. In fact, it turns out that the Defense Department has not negligently allowed itself to be hoodwinked. Most of these

<sup>1</sup> Of these, four proved not to be "bureaucratic absurdity" after all, but rather policies enacted by Congress. So only six cases were investigated. In addition, I examined the issue of Defense Department spare parts prices (which appeared in the press packet under another listing) because the issue had received so much media attention and because it had the horror-story sound of the other examples of "bureaucratic absurdity."



cases have a common explanation, which involves an accounting quirk in pricing material purchased from contractors.

Any time anybody buys something, the price includes not only the direct cost of the materials, machines, and labor to produce it, but also a share of the company's overhead expenses—ranging from running the legal department to renting corporate headquarters. Defense Department acquisition rules prescribe that a defense contractor's overhead expenses be allocated to each shipment at some fixed proportion of the value of the procurement. Thus, if the direct cost of a weapon is \$5 million, a company might be authorized to tack on, illustratively, 20 percent or \$1 million, for overhead expenses. The same percentage may also be added to the direct costs of other items procured, such as spare parts. Thus \$1 million would be added to a spare parts order for \$5 million, just as it would be to a fighter plane order.

The Pentagon orders many different spare parts at one time. Often in the past, contractors have, simply as a matter of accounting convenience, allocated the overhead to the individual parts on an "item" basis rather than a "value" basis. Say that the \$20 million order is for 10,000 parts, some of which have a direct cost of \$25,000 each and others of 4¢ each. Instead of apportioning the \$1 million total overhead such that the \$25,000 part gets a lot and the 4¢ part a little, the computer printout will allocate \$100 to each part. This produces a charge to the government of \$25,100 for the expensive part and \$100.04 for the cheap one.

Although this produces horror stories, nothing horrible has occurred. The total overhead represents real resources legitimately charged to the government. If the \$100 doesn't get allocated to the 4¢ diode, the diode no longer appears to be so outrageously expensive. But the \$100 doesn't disappear, nor should it. The overhead is just allocated elsewhere.

There is one mildly distressing aspect of this practice. The spreading of overhead costs over a contractor's entire production appears to reduce the up-front costs of new weapons systems, since research and development for the weapon is charged to spare parts as well. This, in turn, makes new weapons systems appear less expensive than they really are, and distorts political discussions of a system's costs and benefits. But that has nothing to do with "not minding the store."

Other horror stories have a different explanation. Many parts the Defense Department procures are "common use items," the same as commercially produced parts that might be used in a car as well as a tank. Other items need to be custom designed, which often pro-

duces an extremely high price per unit, because, unlike Chevrolets, much military equipment is produced in very small quantities and thus requires only a few of the same spare parts. The initial cost to design the part, and make the machine die or molding to produce it, must then be spread out over only a few units. (If it costs \$3,000 to design and tool up a plastic cap, that will add only 1¢ to the cost of the cap if 300,000 are produced, but \$1,000 if three are produced.)

The economics of tooling-up do suggest that common-use parts be used when possible, and the Defense Department does make efforts to get common-use items. Spare parts are frequently procured on a sole-source basis from the contractors for the original weapon. When the contractor submits designs for spare parts, he must designate those which are common-use. This list is reviewed by a Defense Department contracting officer, who makes suggestions for expanding common-use procurement when appropriate. After the contractor proposes prices, the contracting officer requests an independent evaluation of the offer by Defense Department value engineers, who may question whether a newly designated part is sufficiently different from common-use items to justify special tooling-up. But special design is sometimes necessary.

Contractors have something of an incentive to propose custom-designed parts, since a contractor is allowed to take a standard percentage profit, which in dollar terms is of course far greater for a \$1,000 item than a \$1 item. Cheating is presumably discouraged by the negative impact repeated discovery would have on the contractor's relations with the Defense Department. But the Department has an enormous review task—there are about 300,000 parts in an airplane—and sometimes an item that should have been classified as common-use ends up getting designed to order. This is what happened in the case of the \$1,118 plastic cap. In the widely publicized case of the \$9,609 Allen wrench, however, the system did work. General Dynamics proposed a custom-designed wrench, but the Pentagon's value review engineer found that the function could be performed equally well by an ordinary wrench. The Defense Department never ordered the custom-designed version, and is now increasing its scrutiny for common-use items. The additional scrutiny may cost more than it saves, but the issue to the Defense Department at this point is the credibility of the defense buildup.

#### The outrageous case of building management

(2) *"In comparison to a private sector company, managing comparable building space, the General Services Administration employs*

*17 times as many people and spends almost 14 times as much on total management costs."*

This contention is so wildly inaccurate that it is hard to know where to begin. The best place to start is with two whopping errors in the numbers the Grace Commission provided on the private sector firm being compared with GSA. The chart the Commission provided stated that the property management division of a large life insurance firm was managing 10,000 buildings, "comparable building space" to GSA. In fact, no insurance company has a portfolio anywhere near that large. The correct number for the insurance company is not 10,000 buildings, but 1,000, which is not comparable to GSA at all. Furthermore, the Grace Commission states that the insurance company employs a total of 300 professionals, 100 in central administration, and 200 under contract. It turns out, however, that the company in question does not employ 200 *individuals* under contract, but rather hires 200 property management *firms* actually to manage its buildings. Each of these firms in turn has many professionals working for it.

The figure the Commission chart provided for GSA professionals—5,000—is also exaggerated. About one-third of these are clerical and other non-professional employees (the Grace Commission simply looked at total white-collar employment at the Public Buildings Service). And about 800 of this number manage GSA design and construction, overseeing the contract process for construction of new buildings as well as repairs and alterations of existing buildings; the people who do this for the insurance company work in a different division, and thus aren't included in the employment figures the Grace Commission provided. So the number of professionals working on building management at GSA is really around 2,700, rather than 5,000.

Although all this indicates that the Grace Commission is monumentally mistaken, a precise comparison is difficult to make. One would need to know how many professionals the building management contractors employ, and the insurance company itself doesn't know that. Beyond that, the nature of the GSA portfolio and the insurance company's portfolio is different. Over two-thirds of the GSA buildings are leased space rather than owned space; this requires people to work on initial lease bids and on lease renewals (neither of which applies to the insurance company), but does not require government-provided building management services. Over 1,000 of the GSA buildings are (owned or leased) local social security offices, which are considerably smaller than the properties an

insurance company owns. GSA officials would themselves concede that they probably have a larger staff for comparable functions than a private sector counterpart, because GSA requires more levels of review on contracting and leasing decisions to assure due process and to minimize corruption. But the difference is nothing like 17 to 1.

### The \$61,250 nursing home bed

(3) *"The VA spends \$61,250 per bed to construct nursing homes—almost four times the \$16,000 per bed cost of a major private sector nursing home operator."*

The Grace Commission averaged the cost of six VA nursing homes, and the average was raised dramatically by the reported \$113,500 per-bed cost of construction of a home in Martinsburg, West Virginia. This nursing home was being built simultaneously with a VA hospital adjacent to it, and the cost the Grace Commission reported included construction costs for a domiciliary that was part of the whole medical center, as well as site preparation and utilities for the entire complex. The actual cost for the nursing home at that site was \$29,000 per bed, bringing the average cost per bed for the six facilities down from \$61,000 to \$47,000. Furthermore, the cost of three of the VA homes was significantly higher than usual because of unfavorable site conditions (such as confined space for construction, thus requiring off-site warehousing of building materials). Site conditions were unfavorable because the nursing homes were being built next to already-existing VA hospitals, pursuant to VA policy. The average cost of the remaining three homes, built under normal site conditions, was \$39,000 a bed. So while the Commission exaggerates, there remains a substantial difference compared with the private sector, even if one considers only the homes constructed on normal site conditions.

Why these differences? Whatever the answer, one can be relatively confident that it is not the result of lazy government construction workers or bloated construction material prices paid by government. In fact, the VA does not construct nursing homes itself. It takes its nursing home specifications and puts them out to bid by building contractors. The low bid wins.

The truth is that what the VA calls a nursing home is in many ways of much higher quality than what private-sector chains produce. These quality differences increase the cost of a VA nursing home relative to a private one.

The most obvious differences involve the physical designs. VA facilities have been top-of-the-line. Homes have routinely included

balconies in each room, occupational therapy areas, quiet rooms, extensive recreation space, and on-premises artwork. The VA policy of building homes contiguous to VA hospitals rather than freestanding, as the private company Beverly does, is also quality-driven; it provides nursing home residents quick access to hospital services and allows more rapid treatment of medical emergencies. That policy drives up costs in a number of ways, however. The VA got into the nursing home business relatively recently, and most homes are built on existing hospital sites. Often, however, these sites are too small to be ideal for new construction. That can raise costs by requiring construction in cramped or otherwise difficult situations. And frequently there is not enough land to build single-story homes, which are marginally cheaper to construct than the two-story homes the VA often must build. Is it worthwhile to produce this level of quality? That is a matter of debate. But it is not an issue of "waste," as the term is typically used.

The cost of constructing VA nursing homes *can* be reduced by decreasing quality. In 1981 the VA established a task force on nursing home construction cost reduction, after private nursing home chains had called cost differences to the attention of congressional oversight committees. The task force proposed a number of design changes that will reduce the cost of new VA nursing homes by about \$12,000 per bed. They include eliminating balconies, making ceilings eight rather than nine feet high, reducing recreation room and dining room space by 35 percent, and reducing landscaping by half.

Another part of higher VA construction costs stems from the special requirements of government procurement. The most obvious are ones such as Davis-Bacon, and the preference given to American-made products and to minority and small-business enterprises. When the government builds a nursing home, it has decided not just to build a home but also to aid small business and American-made products. Again, this is not "waste," but rather government policy.

The entire mode of procurement in government is a less obvious, but very important, source of additional costs. Private sector nursing home chains generally establish ongoing relationships with construction firms in an area (often two firms, each to serve as a competitive check on the other), to whom they turn again and again. This allows them to avoid the costs of gearing up for new bidding procedures for each job. By contracting for several jobs at the same time, it allows the general contractor to obtain lower prices from subcontractors and suppliers, who give quantity discounts for the larger volume of work. It allows the contractors to become familiar



with the details of how the firm wants the home built and to look for ways to build more economically, since investments in such efforts can be capitalized over a number of projects. The VA, by contrast, must gear up for a *de novo* bidding procedure, open to all, for each construction contract, with detailed functional specifications (rather than brand-specific ones) so that nobody is excluded from bidding. There are many layers of review within the VA to ensure that specifications inhibit no one, and to clear any deviations by the procurement or project staff from the rule that the lowest bid must be accepted. These procurement methods entail extensive additional costs, both because any individual act of procurement is more complicated (developing functional specifications, layers of review) and personnel-intensive, and because there are far more separate procurement decisions to be made (the *de novo* bidding process). Although the monetary costs of these procedures outweigh their monetary benefits (or else private firms would follow similar procedures) none of them, again, constitutes a clear example of waste. At worst, they reflect mistaken policies. They produce outputs with "quality" features not found in private home construction such as equal opportunity for all businesses to compete and a minimization of kickbacks.

Where does all this leave the VA/private sector comparison? I start with a \$39,000 per bed average figure for the nursing homes built on normal site conditions, and I subtract \$6,000 per bed in savings from the cost-control task force.<sup>2</sup> This brings the VA cost down to \$33,000 a bed, compared with \$16,000 in the private sector: about twice as much, rather than four times as much. The costs of Davis-Bacon and various statutory procurement preferences, of complex procurement procedures that must be repeated each time a home is built, of any remaining quality difference compared with private sector homes, and of any extra costs from two-story construction, reduce the differences further. Since no study exists of the accumulated effect of those factors, it is impossible to say how much of the VA/private sector difference that does remain is simple waste. My suspicion is that something does remain, but that the differences are not dramatic.

<sup>2</sup> I subtract \$6,000 rather than the estimated \$12,000 in savings because some of the changes the VA is making bring VA nursing homes below Beverly's standards—for example, the ceilings in VA homes will now be lower than those in Beverly homes. Lacking time, or expertise in architecture, to allow an exact estimate of the cost-reduction steps that bring the VA homes to the same level as Beverly's, I have taken a figure of one-half, the arbitrary nature of which the reader should be aware of.

### The freight-charges boondoggle

(4) *"The government spends almost \$5 billion annually on freight charges but doesn't bother to negotiate volume discounts with suppliers."*

The Grace Commission's own backup material regarding this claim turns out not even to make the contention that the government "doesn't bother to negotiate volume discounts." In fact, it turns out that virtually all government freight is moved at rates discounted for volume.

The problem is a more subtle one. Before trucking deregulation, freight tariffs were fixed. Deregulation in 1980 produced an avalanche of different rates (similar to the situation for airline travelers). Suddenly, there were differences in fares charged for a given route and many lower tariffs for full-load shipments.

Deregulation opened up opportunities for savings on freight expenses, but the proliferation of rates increased the information-processing requirements for taking advantage of those possibilities. Very quickly, computer software companies began offering packages that allow a shipper to determine the cheapest available rate, and also to determine what shipments from several sources within the organization might be going to the same place at the same time, so that full-load discounts can be obtained. These systems have spread quickly in the private sector since 1980.

In 1981 the General Services Administration, which administers shipping for most of the government, began to look at these new computer systems, but decided they were still too new to try. In the summer of 1983 they decided to procure one, and the system they selected went on-line in March 1984.

### The mailing list fiasco

(5) *"Government mailing lists erroneously repeat the same addresses as many as 29 times."*

This statement, though ambiguous, seems to suggest that somewhere there is a government mailing list that has the same address on it 29 times, causing 29 copies of the same publication to be sent to one location. The implication is that government officials simply never bothered to check the list for such wasteful duplication.

This example of 29 repetitions comes from a 1980 effort by the Office of Human Development Services in HHS to improve its management of mailing lists. The Office was formed in the mid-1970s as an umbrella organization for a large number of already existing



agencies, such as the Administration on Aging and the Administration for Children, Youth and Families. Each of these separate organizations, quite naturally, maintained its own mailing lists—usually, in fact, a number of different mailing lists, such as lists of subscribers to an agency magazine, media contacts, libraries, or recipients of grant award information. There were about 300 different mailing lists in all.

In 1979, a newly appointed manager of the Office of Public Affairs at Human Development Services persuaded his boss to authorize a project to centralize and modernize the organization's mailing lists. The 300 lists were combined into one master list. A "positive purge" was conducted, whereby every person on any of the lists had to return a card in order to stay on. The Public Affairs Office also began to rent commercially available lists—of libraries, professors of social work, etc.—as an alternative to maintaining and updating its own lists.

In the course of this project, it was discovered that one address (a social service agency) appeared 29 times. But this was 29 times on 300 different lists, and these 300 lists generally received different publications. In other words, the addressee might have been on one list to receive the *Mental Disability Law Reporter*, on another for press releases from the Administration on Aging, and on a third for information about grant availability from the Office of Handicapped Individuals. The addressee wasn't receiving 29 copies of any one publication. At worst, as the person in charge of the reform effort told me, an addressee appearing 29 times might receive five copies of a single publication—but only in the rare cases when a mailing went to several of the agency's *different* lists. There were certainly some examples of duplications on the same list: Although federal law requires annual canvassing of individual agency lists for duplication, compliance is mixed.

Although the quality of mailing list management within the government varies, there is no doubt that significant improvements could be made. There have been major changes in the mailing list business during the last decade, with the increased use of computers for list generation and management. Simple software now exists to purge lists of duplication, and with the growth of list brokers there is no longer any need for an organization to attempt to maintain its own lists of nursing home administrators, libraries, or public health professors. The government is now beginning to adapt to these changes.

### The scandal of seized assets

(6) *"The Justice Department just sits on the cash seized from criminals, not bothering to deposit the money in interest bearing accounts while cases are being adjudicated."*

Traditionally, cash seized from criminals was indeed not deposited in interest-bearing accounts. "Not bothering," however, was not the reason. Prosecuting attorneys wanted the actual bills in hand, to impress juries with wads of ill-gotten lucre. Depositing the money would have meant losing the ability to show it to juries: The only thing available would have been a statement in a government bank account! Furthermore, some jurisdictions require that actual bills be submitted as evidence.

Until quite recently, very little cash was seized from criminal suspects. In the late 1970s, however, the Justice Department began actively to seize cash and physical assets (such as cars and boats)—and to seek their forfeiture—as a tactic against organized crime.

Soon thereafter, the Department realized that this vast quantity of physical assets had created a management problem. The Justice Department's policy was not to question legitimate third-party liens on seized assets, so that if there was a \$110,000 loan outstanding on a \$150,000 boat, the government would not contest the bank's right to collect \$110,000 from the sale of the boat. The frequent problem is that the hypothetical boat might deteriorate badly while in the government's possession. When sold after being forfeited, less than \$110,000 might be realized; the government would have to make up the difference. The local U.S. Attorney offices had no capability to manage seized assets while they awaited disposition (lawyers are experts at trying cases, not managing property), and no centralized management system had ever been developed because there were so few seized assets.

In 1981, the Justice Department appointed a task force to examine the management of seized assets. It issued a report in 1982, recommending that the Department establish a central organizational capability, through the U.S. Marshal Service, to manage seized assets for local U.S. Attorney offices. Agreement having been obtained within the Department (including from the U.S. Attorney offices), this new capability is now being established.

### The shocking sloth of loan collectors

(7) *"HUD makes only 3 attempts to collect loans versus 24 to 36 tries in the private sector."*

This refers to loan collection procedures for two programs—a Housing and Urban Development credit insurance program for regular property improvement loans (Title I), and HUD's direct, subsidized loan program for property-improvement loans in disadvantaged areas (Section 312). Title I is an old program (enacted in 1934) that does not have income restrictions; Section 312 is a War on Poverty-era program that is targeted to poorer neighborhoods.

Again, the comparison the Grace Commission presents is exaggerated. First, the Grace Commission's own backup material refers to two or three loan collection tries per month in the private sector (compared to a total of three in HUD), but collection activity, in both the private sector and HUD, proceeds for only four months before legal action is commenced or the loan abandoned. The press packet figure of "24 to 36 tries in the private sector" comes from incorrectly assuming that collection activity at private banks goes on for an entire year. Even accepting the Grace Commission comparison at face value, the proper number is thus eight to 12 tries in the private sector, not 24 to 36. Second, HUD loan collection officers generally do not make a written record of telephone calls they make to delinquents, so Grace Commission investigators looking only at the written record underestimated the number of collection tries HUD made. Finally, and crucially, there has been collection activity on these loans *before* they are sent to HUD. Title I loans are made by regular banks, and Title I regulations mandate that the banks pursue their own normal debt-collection efforts before passing the loans on to HUD; for the Section 312 loans that HUD makes directly, Fannie Mae (the Federal National Mortgage Association), which services the loans, engages in some mild collection activity (dunning letters but no phone calls or contacts with an employer) before passing the loans on. HUD isn't starting from scratch on collections, as the Grace Commission's comparison suggests.

None of this is to suggest that there have been no problems with debt-collection at HUD. Although the regulations call for banks to pursue normal debt-collection efforts first, HUD officials concede that compliance is mixed. Also, when their own collection efforts fail, private banks give potentially collectible loans to private collection agencies, and HUD gives them to the Department of Justice for prosecution. Attorneys there have regarded these as low-priority cases and have not prosecuted them in a timely way—something that debt-collection experts regard as crucial to any chance of recovery. Finally, at least for Section 312 loans, management at HUD has probably always regarded these loans as a sort of disguised social

assistance program, and has seen the idea of banging on the doors of poor people to get them to pay as distasteful. Loan collection efforts for the 312 program traditionally received little attention from top management. (The Title I program, by contrast, turns a profit for the government.)

The organization of debt collection at HUD has also failed to reflect changes in private debt collection practices. HUD standard operating procedures continued to call for personal dunning visits to delinquents, although banks had concluded over a decade ago that such efforts (earlier traditional in the industry) were generally not cost-effective. And HUD was very slow to computerize debt information, which resulted both in a great deal of clerical work for loan collectors (reducing the time available for collection activities) and in poor control over the status of files. The Section 312 program began to move toward computerization (and now to contracting out its debt collection to a private firm) after a critical report by the General Accounting Office in 1979; Title I has only recently computerized its collection activities, after a decision to do so was made by the assistant secretary appointed by President Reagan.

### Fat City at the VA

Beyond the issue of nursing home beds, the Grace Commission made a number of specific contentions about Veterans Administration activities that are similar to private sector activities, but allegedly cost much more.

Perhaps the most dramatic was that it costs the VA \$140 to process a claim for hospital coverage, compared to \$3 to \$6 for private sector insurance companies. This is wildly inaccurate. The Grace Commission listed the General Accounting Office as its source, but the GAO denies ever having made such a calculation. Dividing the total dollars spent by the total number of claims the VA processes yields a cost of \$5-\$7 per claim. This figure is still slightly higher than the private sector average, but the VA's claim-processing procedure is necessarily more complicated. In processing a claim, an insurance company often must determine only the amounts for which a beneficiary is covered. Statutes determining eligibility for VA medical care, by contrast, often restrict coverage to health problems related to service injuries, to emergency treatment, and so forth. This frequently requires extensive investigation. Whether VA claims-processing is still somewhat more costly even after these differences have been taken into account is hard to say.

Also in the area of claims processing, the Grace Commission stated that it takes the VA 25 to 40 days of internal processing time (that is, after all the appropriate documentation had come in) to process a veteran's pension or compensation claim, compared to an average of four days in the private sector for processing similar long-term disability claims.

The Grace Commission contention is correct. The main reason for the difference is that the VA's procedure requires more layers of review. In the private sector, the entire process would typically be handled by a single person. The claim reviewer would request any information needed, review it, and authorize payment. The VA procedure, by contrast, involves four separate reviews. First, a medical rating board makes a medical judgment about the extent of disability. At this point local representatives of service organizations such as the American Legion examine and comment on the file, as authorized by statute. Then an adjudicator determines how much money the claimant will receive. And finally an authorizer reviews the case from scratch. This procedure is designed to provide safeguards for veterans.

The Commission also made two criticisms of the way the VA purchases drugs and supplies for its hospitals. The first was that the VA does not make sufficient use of bulk discounts. Proprietary hospital chains, the report stated, obtain 75 to 85 percent of their supplies through bulk purchases, the VA only 60 percent.

The Grace Commission figures are correct. Why the difference? Essentially, the explanation involves the fast pace of change in medical technology. New medical products come on the market constantly. They are typically used first at scattered local hospitals, where some doctor, one way or another, has found out about them. If the innovation is a good one, use will gradually spread, but in the early stages there is insufficient national demand to warrant national (i.e., bulk discounted) purchasing. Gradually, though, successful new products are bought in sufficient quantity to warrant this move. It is the slowness of the VA, compared with the private sector, in moving its purchases of new products from local to national contracts that accounts for the greater proportion of local purchases. This is because the VA's system for purchasing supplies is not computerized; other uses of the VA's computer budget have hitherto been regarded as higher priorities.

The other Commission criticism involved the method of storage for supplies procured through national contracts. Since the 1940s, the VA has operated central warehouses to supply individual hospi-



tals. Products are delivered directly to warehouses and transported to individual hospitals as they are ordered. Advances in distribution technology, the Commission stated, have made warehouses uneconomical; proprietary hospital chains, the report said, have rejected warehousing.

The VA presents different figures. It claims that running a warehouse system adds only 15 percent to costs, not the 30 percent that the Grace Commission claimed. The VA claims that this 15 percent is more than offset by the lower prices that suppliers charge for single-point delivery to warehouses, as against multiple-point delivery to individual hospitals. They point to several studies by the General Accounting Office and the VA Inspector-General supporting the cost-effectiveness of the depots.

It is hard to know whom to believe. On the one hand, the VA provides specific dollar breakdowns of its costs for running the warehouses, while the Grace Commission merely cites "experts in materials management." What is clear, however, is that the VA does worry about the cost-effectiveness of running central warehouses. The VA generates computer data on each item procured to the warehouses, terminating those that do not meet its criteria for warehousing: When the warehouses were first established, *all* nationally-procured products went through them; now, only about half do. On the other hand, if private hospital chains have indeed considered and rejected a warehousing system, and if their situation is comparable, that is strong evidence on the other side. Top management at the VA, itself unsure, has now commissioned an outside consultant to study the warehouses.

### Torpor at the GSA

Two of the specific Grace Commission claims about the GSA involve maintenance management and energy conservation.

The Commission claimed that "maintenance productivity," defined as the proportion of maintenance workers on the job at any given moment, was 60 to 65 percent in well-managed private firms but only 40 to 45 percent in the government. It is difficult to determine whether these claims are accurate. The "survey" of government performance to which the report referred turns out to have been, to put it generously, far more impressionistic than the report implies. A Commission member simply made casual observations at government locations he was visiting in connection with his other Commission responsibilities. That the evidence is impressionistic does not, of course, mean it is incorrect. The GSA itself doesn't gen-

erally measure maintenance productivity the way the Grace Commission does (and differences in how to measure it are apparently quite common), so there is no hard evidence to contradict the report. But what one can say is that traditionally, in both the private and public sectors, maintenance was scheduled manually. Over the last five years or so, though, the private sector has come more and more to rely on computerized maintenance management systems. These decrease the non-productive time of maintenance workers by allowing them to perform several activities on each trip to a given building. The computerized systems also make it easy to compare the amount of time actually spent on a task with the standard amount of time for such a task.

In 1982 GSA began to investigate acquisition of such a computerized maintenance management system: Maintenance managers had seen these systems on exhibit at trade shows and read about them in the trade press. They wanted to keep up with the "state of the art." After examination of prototypes and delays for budget approval, a system has now been leased and has begun to operate.

On another subject, the Grace Commission stated that "although GSA has reduced annual energy costs significantly by daytime cleaning and other measures, little has been done to implement an Energy Management Control System, which has proved highly successful in the private sector." Such systems monitor data on building temperature and "enable heating and cooling units to be turned on and off—remotely and automatically—according to predetermined conditions."

But the "other measures" GSA has already taken accomplish much of what energy management control systems do. Government buildings already have timers and other devices to turn heating and cooling off and on. Buildings constructed since 1974 have centralized computer systems for this purpose. Consumption since 1973 in GSA buildings is down 30 percent even in the face of the rising demands owing to office automation. The Commission states that an energy management control system reduces consumption by 5 to 10 percent. GSA believes that the marginal benefit of adding such systems to the measures already undertaken rarely outweighs the marginal cost.

### Waste in government?

There are a number of conclusions one can draw from all of this. First, the horror stories one hears are almost always gross exaggerations. What we have seen suggests that those responsible for the



activities in question generally pay attention to costs, and have a fairly good sense of ways to keep them down. People are too quick to conclude that programs are wasteful when they think the programs are not worthwhile. But if the government efficiently delivers a worthless product, the criticism should be directed at the decision to deliver the product, not vented in charges of incompetence and venality against those making the deliveries.

Second, some differences between relative costs to government and to the private sector occur because the government, superficial similarities notwithstanding, is in fact producing something very different. This is most obviously the case when, for instance, the VA puts balconies outside its nursing home rooms. But it is also the case when agencies follow cumbersome procurement procedures designed not solely to procure certain goods, but also to ensure due-process for vendors and special aid for disadvantaged businesses. There may indeed be incentives in some government programs, such as those administered by the VA, to overproduce quality. And it may be that we are spending too much for due process. But the extra money entailed has not simply disappeared down a black hole.

Third, even after taking account of quality differences, it is probably true that government generally produces a given output less efficiently than the private sector. If I had to hazard a guess, I would say that the government might typically use, not four times or 17 times as many resources as the private sector to produce a given output, but perhaps 1.2 times. That is less dramatic, but it does add up. Even if it adds up only to several billion dollars, rather than to the Grace Commission's fantasy figures, such a sum is negligible only to those who, to paraphrase Everett Dirksen, have gotten so used to spending a billion here and a billion there that they forget it eventually adds up to real money.

Fourth, government is not very good at turning on a dime. As we have seen, there are many situations in which the environment changed—computer programs becoming available, for example—and it took more time for government to adapt than for the private sector. But, as we have also seen, the government does in fact adapt.

But if the Grace Commission exaggerates badly, waste is nonetheless a problem. We should, with modest expectations, still look to see what changes are possible that might, at the margin, improve things.

First, public managers should aggressively look for quantifiable measures of performance. How many complainants does an employee of a local Social Security office see each hour, how many

complainants must return with the same problem, how satisfied are complainants with their treatment? Private sector experience suggests that such results-oriented measures can work well. In a number of the Grace Commission examples, managers did have good performance measures available, and performance in fact turned out to be competent. Sociologists and political scientists writing about organizations are remarkably sensitive to the difficulty of developing such measures for government, and to their possible perverse effects. (The literature is filled with observations along these lines: Judging the performance of an inspector by the number of inspections encourages cursory inspections, of small establishments only.)

But the private-sector doesn't seem to be as gloomy. Andrew Grove, president of the highly successful Silicon Valley firm Intel, notes the problem of the perverse consequences of performance indicators, but suggests that this can frequently be handled by developing *pairs* of measures. For example, companies keep inventories to avoid shortages, but carrying inventory costs money. If only shortages are measured, this will encourage overaccumulation of inventory. Therefore, he suggests, pair a measure of shortages with one of inventory carrying costs.

Second, government functions, particularly non-core functions, should be contracted out to private organizations if the same output can be produced more cheaply that way. The issue of contracting out services occasions enormous controversy, mostly of an ideological nature. Yet contracting out occurs all the time within the private sector itself, without ideological overtones. To take some traditional examples, large corporations hire advertising agencies and law firms, rather than keeping everything in-house. More recently there have emerged rapidly growing firms that provide laundry, food, and maintenance services for hospitals and businesses. Private sector firms frequently discover that specialized service providers are more efficient than in-house provision, because of various economies of scale. It shouldn't be surprising if this is frequently the case for government as well. If top management in government agencies prefers to devote its attention to grand issues of public policy, this is all the more reason to let other services be performed by those willing to toil in less glamorous vineyards.

Third, one spur to competent performance is a desire to live up to the standards of one's profession. The decision to adopt a computerized maintenance management system in CSA is a good example; the CSA officials regard themselves as professional building

managers. More broadly, government officials may perform well because they are proud to be in the public service. They believe they are helping people who might not otherwise be helped. The very fact that the organization for which they work is not trying to "make a buck" can be a source of motivation. Whether or not businessmen believe that only the bottom line can motivate, GSA officials I spoke with made it clear that during the energy crisis they believed it was their patriotic duty to reduce energy consumption in government buildings.

Since living up to professional standards and keeping up with the profession are important substitutes for a missing marketplace environment, the development of a sense of identification with a larger professional community should usually be encouraged (though there are cases where professional identification can have a negative impact: If government lawyers can't conceive of any way to accomplish governmental purposes besides bringing lawsuits, we will have a problem). Since pay scales for top government managers will never be high enough to allow the public sector to motivate by appealing to the prospect of great personal wealth, this alternative will have to do.

More generally, we need desperately to foster within government the sense that public managers *are* indeed managers. At the end of his *Managing the Public's Business*, Laurence E. Lynn, Jr., who has had extensive experience in government, stated that improvements in governmental competence require that public managers "take the time to manage." This statement is noteworthy for what it suggests about current practice. One would think it superfluous, and certainly it would be if directed at most private sector managers. Yet many career government managers, promoted because they were good at lower-level jobs calling for individual accomplishment, are never told that being a good manager is not the same as being a good individual achiever; and many politically appointed executives have had no previous management experience. The increased use of management training for newly appointed career managers, as well as (if I may be permitted a bit of institutional chauvinism) the growth of professional schools in public policy and management, can contribute to the growth of this necessary culture of public management.

Finally, a number of institutional changes, some moderately difficult and others excruciatingly so, would help. Some changes in the budget process could address the problem of waste specifically. Annual appropriations cycles often waste money, since weapons

systems and spare parts, for instance, may have to be ordered in uneconomical quantities in order to stay within the year's budget. There are cautious signs of willingness in Congress to accept multi-year procurements, as well as so-called "zero year appropriations," wherein an agency can spend a certain sum for capital equipment, but the year is not specified.

Furthermore, unlike a typical private firm, the federal government does not have a capital budget separate from its operating budget. In private firms, capital expenditures, such as plant and equipment, are not regarded only as current outlays, but also as sources of future revenues (or savings). If a manager wishes to invest \$10 million in some new equipment, he needs to justify that the stream of future revenue (or savings) as a result of the investment is likely to be greater than the cost of capital for the investment. Normally, any investments that meet this test are approved, independent of how much or how little money that means spending during a given year.

The federal budget discourages this. The emphasis is, instead, on an overall level of expenditure, using the previous year's level as a baseline. It is often difficult to get "blips," in the form of lumpy single-year investments, approved, even if spending a chunk of money now will save lots more in the future. The government thus tends to underinvest in capital equipment, such as computers.

Larger, and much more difficult, institutional changes would address not just waste but the broader questions of government performance. One of the greatest differences between the public and the private sectors is the generally greater rule-boundedness in government. Procurement is a typical example: The resources spent on development of detailed functional product specifications to assure access to bidding by many competitors, the strict rules for accepting the lowest bids, the extensive clearances through which all procurement decisions must go to minimize corruption—these not only probably cost more money than they save (or else the private sector would generally use government-style procurement systems, which it doesn't), they also turn government officials into clerks. Rules and clearances also explain the frequent slowness of government's reactions to new situations. Public managers need to be freer to make decisions, to take initiatives, and to innovate; then they must be held responsible for the results.

Having said that, I am unable to present a proposal for making it happen. It is all too easy to understand the incentives that produce fixation, among elected officials and in the media on wrong-

doing, scandal, and horror stories—and hence on rules on clearances to prevent them from taking place. I have only two thoughts. One is that those concerned with public-sector performance need to think seriously about how to make marginal improvements that do not run afoul of these constraints: Are there ways, for example, to structure the procurement system to minimize kickbacks without forcing everything through multiple layers of review? The second thought is that when all else fails, a resort to the merits of the argument may be in order. There are certainly at least some journalists and elected officials who might emphasize a broader view of governmental accountability, if they can be persuaded that attention solely to wrongdoing hurts rather than helps the performance of government, not to speak of public confidence in our institutions.

Good performance by government consists of more than just controlling costs. It requires that elected officials and managers select worthwhile things for government to produce in the first place. And it requires that attention be paid to quality as well, since the cheapest way to produce something may not be the best way. The suggestions outlined here would, I believe, improve the overall quality of government performance, not just reduce waste. By contrast, efforts to "combat waste" by introducing additional rules and additional layers of control are likely to hinder good performance—and may, as the example of the procurement system suggests, not even reduce costs. Yet it is exactly the headline-grabbing horror stories, such as the ones in which the Grace Commission specialized, that lead more than anything to the development of ever-newer rules and clearance points. In this sense, the Grace Commission may have betrayed the "war on waste" it set out to wage.



## In Cutting Back on Pentagon Spending, The Issue Is How As Well As How Much

The most likely cuts would either promote inefficiencies in defense spending or feed fears that too large a share is going to strategic nuclear weapons programs.

BY MICHAEL R. GORDON

What a difference a deficit makes! A mere two months ago, Democratic presidential candidate Walter F. Mondale, whom Republicans assailed as soft on defense, was promising to pump up military spending by 3.4 per cent after inflation.

But with President Reagan's reelection, influential Republicans on Capitol Hill are leading the charge to restrain the pace of defense spending—and the notion of a military spending "freeze" is very much in the air.

That prospect is a major irony that stems from the President's decision to seek more social spending cuts while at the same time opposing a tax increase.

To a large extent, the debate over the appropriate level of defense spending has nothing to do with defense. Instead, it revolves around the political fact of life that all interests must bear the burden of budget cuts if Congress is to make any sizable reductions this year. And it also turns on the simple economic fact that if taxes are not to be raised, spending cuts remain the only means of getting a handle on the growing federal budget deficit.

But whatever the outcome in Congress, the form of the defense debate is predictable and will very much center on arguments about the appropriate level of mili-

tary spending in the light of U.S. national security concerns.

Defense Secretary Caspar W. Weinberger, who last year asserted that any reduction in the Pentagon's spending requests would undermine national security, has already stated that a defense spending freeze would be the wrong message to send the Soviets at a time when U.S. and Soviet representatives are preparing to engage in arms control talks. Congressional critics contend that the Pentagon ought to be able to make do

would either lead to inefficiencies in defense spending or feed congressional apprehension that a disproportionate share of Pentagon money is going to strategic nuclear programs to the detriment of conventional programs.

But judging the impact of defense cuts is complicated by the Pentagon's reluctance to develop a comprehensive reduction plan for fear that Congress would take it as a guide to making further cuts.

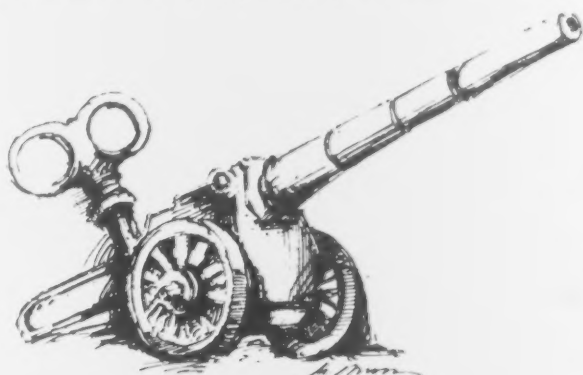
### HANGING IN THERE

As Congress prepares to take on Reagan's defense spending request for fiscal 1986, there is no question that the Administration's defense buildup is already a fait accompli.

From the end of the Korean War until the beginning of the Reagan Administration, the Pentagon had not succeeded in winning real increases in defense spending for more than three consecutive years. The current

Administration has increased defense spending at an average rate of 8.3 per cent a year in real terms. And the Pentagon has now seen real increases in defense spending for six consecutive defense budgets, going back to the midpoint of the Carter Administration.

Weinberger's hang-tough approach to dealing with Congress may have paid some modest dividends as well. Over the past three years, he twice gave Congress a list of recommended defense spending



with defense spending that—in constant dollars—is higher than Vietnam war spending levels.

What effect a defense spending freeze—or a modest defense spending increase of 1-2 per cent above inflation—would actually have on the Pentagon budget and on national security is the question of the hour for Washington numbers crunchers—and one that will be hotly debated by the Pentagon and its critics.

The most likely cuts are those that

## It's Weinberger Over Stockman by a Knockout

President Reagan's support of Defense Secretary Caspar W. Weinberger over Office of Management and Budget director Dave Stockman on the Pentagon's spending requests for the next three years was clearly a triumph for the Pentagon. But Congress will have the final word on whether that victory will stand up.

The table shows Defense Department spending in terms of both budget authority (the amount Congress authorizes

to be immediately or in future years) and outlays (the amount actually spent in any year). It excludes defense spending outside the department, primarily by the Energy Department on nuclear weapons and fuel, which would add about \$9 billion to each year's total of budget authority and outlays. The Reagan baseline was established by the "Rose Garden" compromise last spring between the White House and Senate Republicans.



*The winner: Defense Secretary Caspar W. Weinberger (left). The loser: budget director Dave Stockman.*

| Defense Department budget authority (billions of dollars) |       |       |       |       |
|-----------------------------------------------------------|-------|-------|-------|-------|
|                                                           | 1985  | 1986  | 1987  | 1988  |
| Reagan baseline (spring 1984)                             | \$291 | \$325 | \$362 | \$412 |
| Approved by Congress (September 1984)                     | 285   | 316   | 350   |       |
| Stockman proposal (December 1984)                         |       | 297   | 324   | 358   |
| Approved by Reagan (December 1984)                        |       | 314   | 354   | 403   |
| Defense Department outlays (billions of dollars)          |       |       |       |       |
|                                                           | 1985  | 1986  | 1987  | 1988  |
| Reagan baseline (spring 1984)                             | \$259 | \$286 | \$322 | \$359 |
| Approved by Congress (September 1984)                     | 255   | 280   | 312   |       |
| Stockman proposal (December 1984)                         |       | 278   | 302   | 329   |
| Approved by Reagan (December 1984)                        |       | 278   | 312   | 349   |

SOURCES: Office of Management and Budget, Congressional Budget Office, Defense Department



reductions after the White House had struck a compromise with Congress, Pentagon officials say. But on the fiscal 1984 budget, Weinberger maintained his refusal to suggest spending cuts to the end.

For that year, Congress reduced the Administration's defense spending request by about \$16 billion, a few billion less than in the other years. That evidently encouraged Weinberger in the belief that his budget tactics have been vindicated. As a result, he has yielded little on the fiscal 1986 budget.

Office of Management and Budget director David Stockman had called for reducing 1986 defense budget authority—the amount Congress will authorize to be spent in that and future years—by \$28 billion from the \$325 billion level agreed to in the "Rose Garden" compromise last spring between the White House and Senate Republicans. Stockman's proposal would have allowed a 1 per cent real increase in defense spending for fiscal 1986, to be followed by reductions in budget authority of \$35 billion in 1987 and \$54 billion in 1988, for a three-year cut of \$121 billion.

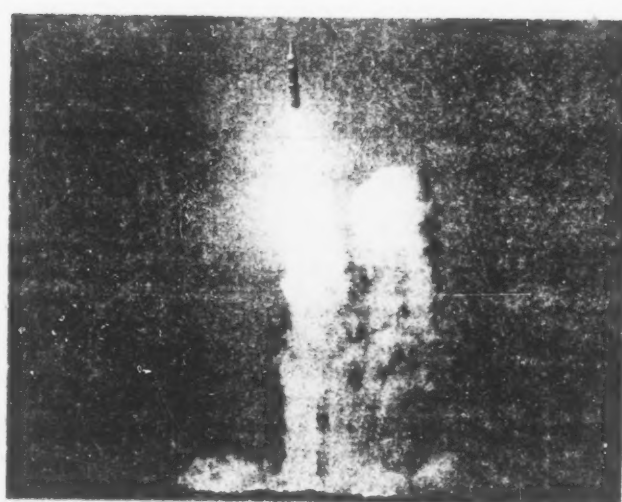
In contrast, Weinberger is seeking roughly a 6 per cent real increase above this year's spending. The effect of his proposed \$11.1 billion fiscal 1986 reduction, he said, would be to reduce budget authority in 1987 by \$8.5 billion and in fiscal 1988 by \$9 billion.

Under the Stockman plan, defense outlays—that portion of spending authority that would actually be expended in any year—would be cut by \$8 billion in fiscal 1986. As it turned out, Weinberger proposed an \$8.7 reduction in outlays for that year, which led to press reports that he had met OMB's budget targets. But in announcing the \$8.7 billion reduction, Weinberger counted the planned reduction in civilian pay, which Stockman had already included in his \$34 billion package of domestic spending cuts.

The more important point, however, is that Weinberger spurned Stockman's three-year defense package of \$58 billion in outlay cuts. Instead, the Defense Secretary's proposed \$8.7 billion in outlay reductions would be followed by cuts of \$9 billion in 1987 and \$10 billion in fiscal 1988, for a three-year total of less than \$28 billion. (See box, p. 8.)

Reagan's acceptance of that spending plan was clearly a victory for Weinberger and the Pentagon.

Still, the Administration may run out of luck this year. There is strong congressional interest in both a "nominal freeze" on defense budget authority, which would not compensate for inflation, and a "real freeze" which would take account of rising costs. Barry Goldwater, R-Ariz., the new chairman of the Senate Armed



The likeliest cuts may feed fears that too great a share of defense funds

Services Committee, favors the first idea, and William L. Dickinson, R-Ala., the senior member of his party on the House Armed Services Committee, supports the real freeze.

Given the spending commitments of past years, there is no realistic way to freeze outlays. A recent congressional analysis shows that if a nominal freeze were imposed for fiscal 1986, outlays that year would still go up by \$14.6 billion.

A more likely outcome than a nominal or real freeze may be a decision to hold defense spending to a very low rate of real growth of about 1-2 per cent.

#### WHERE TO CUT

Ascertaining just what such retrenchments would do to defense planning is not easy, partly because some in the Pentagon do not want to know the answers.

A Defense Department official said it is widely assumed in the Pentagon that the military services and elements of the sizable civilian bureaucracy are working on budget reduction plans, although those proposals are not being circulated within the department.

But there has been no in-depth examination of how a budget freeze would be implemented, he said. That reflects the concern on the part of Pentagon officials that the existence of such a study would become known and allow Members of Congress to argue that the department has provided a road map for what can be done.

No similar budget cutting studies were carried out before the White House arrived at its Rose Garden compromise on

the fiscal 1985 budget last spring; that compromise was based on similar concerns about the impact of defense spending on efforts to hold down the deficit. Two years ago, when future President Ford suggested stretching out the five-year defense plan over six years, with Pentagon officials tried to assess the implications of such a move. But the existence of such analyses were not publicly known.

Despite the difficulty of assessing the effects of a budget freeze on a greatly restrained rate of defense growth, defense budget experts inside and outside of the Pentagon say that achieving sizable reductions in planned defense spending is possible, if only because similar reductions have been accomplished before.

That Congress could reduce planned defense spending to a marginal growth rate or even freeze it at current levels without inordinate difficulty is clear.

In each of the past three years, Congress has cut an average of \$16.1 billion from over all defense spending, including the Pentagon budget. Energy Department programs to reduce nuclear warheads and nuclear fuel for submarines and civil defense programs. The following chart shows those cuts in billions of dollars of budget authority, by fiscal year.

|      | Request | Enacted | Reduction |
|------|---------|---------|-----------|
| 1983 | \$26.1  | \$24.5  | \$1.6     |
| 1984 | 28.0    | 26.4    | 1.6       |
| 1985 | 31.4    | 29.2    | 2.2       |

If Congress went for a freeze, it would require a smaller cut in terms of dollars than last year's defense report said.

For fiscal 1986, the report's defense



... Is going to strategic weapons at the expense of conventional ones.

spending request is expected to stand at \$322.6 billion. Congress, to implement a budget freeze that allows for an inflation rate of roughly 5 per cent, would have to cut budget authority by about \$15 billion, to \$307 billion.

The Pentagon can be expected to argue that such a freeze would be crippling because Weinberger is asking for a real increase of only about 6 per cent, while in past years he sought increases of more than twice that percentage.

But congressional critics will be prepared to counter that Pentagon argument with the assertion that defense spending has grown at an annual real rate of 8.3 per cent over the past five years, pushing military spending to higher levels, in constant dollars, than prevailed during the Vietnam war.

"One of things to remember is how big the base has gotten," said a defense expert. In 1980, a 1 per cent real increase in defense spending would have amounted to \$1.9 billion. In the fiscal 1986 budget, a 1 per cent increase would come to about \$2.9 billion.

#### NO EASY CUTS

Still, that is not to say that defense cuts will come easy—or that they will not hurt defense planning.

This is so for several reasons. First, there are no easy cuts that remain to be made. In outlining his spending proposals, Weinberger claimed as "reductions" about \$1.6 billion in budget authority (and \$900 million in outlays) that will not be needed because of revised estimates of inflation and fuel costs.

Other "easy" cuts are not there for the taking. The President's Private Sector Survey on Cost Control, popularly known as the Grace Commission, has asserted that billions of dollars in defense funds could be saved through better management. But many of the commission's recommendations lack credibility, in the view of Defense Department and outside experts.

Before the commission's report came out, the Office of the Defense Secretary critiqued the study and forwarded its comments to White House counselor Edwin Meese III. The Pentagon documents, marked "close hold," have never been made public. But a copy of the comments, obtained by *National Journal*, shows that defense planners attach little credibility to many of the commission's recommendations.

"The timing and magnitude of the cost savings are very unrealistic," noted the review by the Secretary's office, which added that commission members "took on more than they were qualified to do when they recommended such sweeping changes to the [Defense Department's] organization."

The Pentagon critique was generally consistent with an internal review of some of the commission's findings by retired Adm. I.C. Kidd Jr. that was later forwarded to the White House. Reviewing the commission's report on savings on Air Force programs, Kidd took exception to estimates of savings from multiyear procurement and wrote, "It is flat wrong to say that the Air Force can achieve savings of approximately \$12 billion an-

nually by implementing the 'reforms' cited in the report."

Significantly, most of the commission's claimed savings have been questioned by defense specialists at the Congressional Budget Office and the General Accounting Office who have not hesitated to criticize the Pentagon. (See *NJ*, 2/18/84, p. 332.)

Further limiting Congress's options is its increased consciousness about military readiness. The quickest way to reduce defense outlays is to cut the personnel and the operations and maintenance accounts, which contribute to military readiness. But Weinberger has already proposed about a \$2.5 billion reduction in fiscal 1986 spending by granting a 3 per cent pay raise to military personnel next July—still in the current year, fiscal 1985—and dispensing with a pay raise for fiscal 1986. Congress may further reduce military pay. But given the acrimonious debate over readiness during the past year, it will be difficult for the Pentagon or the Congress to suggest reductions in that area.

#### CUTTING EFFICIENCY

That leaves Congress with several difficult choices, and Weinberger's proposal to make \$11.1 billion in reductions from the Rose Garden level has not made that task any easier. Only \$4.2 billion of that amount would come from military programs. The rest would result from a proposed 5 per cent pay reduction for civilian employees of the Defense Department, deferral of the military pay increase and reestimates of the rate of inflation and the cost of fuel.

A congressional expert complained that Weinberger had not provided "a long-term plan of how to deal with the deficit. He takes it one year at a time, and that means we may face the same problems next year. How many years can we make savings by cutting pay?" Pentagon procurement accounts needed to be cut now, he said, so that Congress would have more flexibility in the next several years in shaping the defense budget. Some experts are concerned that procurement funds have already been so heavily committed in past years that Congress's flexibility is already limited.

That suggests that weapons programs would have to be cut now if Congress is to have that flexibility over the next few years. Canceling entire programs while maintaining the remaining programs at efficient production rates is generally acknowledged to be the most cost-effective way to make defense cuts.

But the more likely course is stretch-outs, which would deal a blow to the management reforms that Weinberger and former deputy Defense secretary

Frank C. Carlucci stressed so heavily upon taking office.

A 1982 study prepared by retired and active generals in the Air Force Systems Command, for example, noted that a 30 per cent cut-back in the form of a stretch-out in the Air Force's five-year procurement plan—which the study noted would not be unrealistic given congressional spending cuts and rising weapons costs—would raise the ultimate cost of those programs by \$6 billion (\$14 billion) (See *NJ* 2/12/83, p. 314).

"What really ought to be done is to better assess the match between resources and plans and drop entire weapons programs or some missions," a Pentagon official said. "But that's hardly ever done." The department's practice of asking for large spending increases and then quickly deciding on budget cuts once the Administration and Congress have cut a deal also hurts planning, he added.

"We have gotten ourselves in a position for which there is no painless exit," said Kevin N. Lewis, a Rand Corp. analyst who specializes in defense budget issues. "There has been incongruity between the initial assumptions and what has turned out to be politically realistic." The Pentagon, he said, should employ "two of their own themes" in cutting the budget. "One is keeping our planned capabilities in track with a realistic view of what can do. The second thing is keep in mind their earlier management reforms. In many cases, it is better to have death by a single cut than by a thousand wounds or nicks."

#### STRATEGIC V. CONVENTIONAL.

Another looming issue—and one likely to be raised by Sen. Sam Nunn of Georgia, the senior Democrat on the Armed Services Committee—is the share of the defense program to be allotted to strategic nuclear systems. In outlining his proposed spending reductions, Weinberger exempted strategic programs. So did Stockman in his suggested budget reductions, perhaps concluding that Congress would do some of the dirty work for him.



The quickest way to reduce defense outlays is to cut personnel and operations and maintenance.

While the Pentagon is planning to ask for funds for 48 new MX intercontinental ballistic missiles, it would be lucky to win congressional approval for half that number. And the MX program could suffer a major setback if Congress votes in April or March against releasing procurement funds for 21 missiles that were authorized as part of the fiscal 1985 budget. (See *NJ* 11/24/84, p. 2240.)

At any rate, a rough analysis of spending trends from 1981-84 shows that the average annual growth in budget authority for strategic nuclear programs has been 27 per cent, while conventional weapons programs have grown 9 per cent.

The comparison may have the effect of underestimating the nuclear share of the defense budget because research funds are not included in the tabulation and a good share of research funds is allocated to nuclear programs and to the Strategic Defense Initiative. Reagan's Star Wars antiballistic missile research system. Moreover, the comparison is arrived at by taking the Pentagon figures on spending on strategic programs as a measure of spending on all nuclear systems even though, by the Pentagon's definition, spending for theater nuclear weapons, such as the Pershing II and tactical nuclear weapons, is excluded.

Pentagon officials argue that the Administration's strategic modernization program has resulted in only a temporary increase in the share of the budget for

nuclear systems. That program calls for buying MX and Trident II missiles, deploying additional Trident submarines, improving continental air defenses and enhancing military command and control. More recently, the Pentagon also committed itself to developing the Midgetman single-warhead missile.

Some Pentagon estimates reportedly shows that under current plans, strategic nuclear spending will take up a smaller share of the defense budget by the late 1980s—perhaps to about 14-15 per cent of the procurement budget, down from 19.7 per cent in the fiscal 1984 spending request and 18.8 per cent in the fiscal 1985 request.

But the Strategic Defense Initiative raises questions about the Pentagon's future strategic spending. And Weinberger's tendency to try to protect nuclear spending during congressional budget review raises the prospect that nuclear spending will claim an inordinate share of the defense budget, according to Nunn and other congressional critics.

In the long run, determining how defense cuts are to be made may be more important than arguing about whether the defense buildup should continue at the rate of 1 per cent or 3 per cent. But it remains to be seen if this more serious debate about how to pare the spending request will be heard amidst the sloganeering on both sides about the level of military spending.



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January 25, 1985

Honorable William Cohen  
131 DSOB  
Washington, D.C. 20510

Dear Senator Cohen:

You are to be congratulated on the recent subcommittee hearings on the Grace Commission and CSIS recommendations. In support of your effort let me add the voice of Heritage.

In December, in Mandate for Leadership II I published a summary report of the Defense Assessment Project. I have enclosed a copy. Our recommendations parallel rather closely those recently released by your CSIS study. I believe that it is important to note that two groups --with rather different perspectives and with a rather different study team make-up --came to very similar conclusions.

I have already briefed our recommendations to Senator Goldwater and to much of the Armed Services Committee staff. I would also be pleased to discuss this with you at any time.

Sincerely,

  
Theodore J. Crackel  
Senior Fellow

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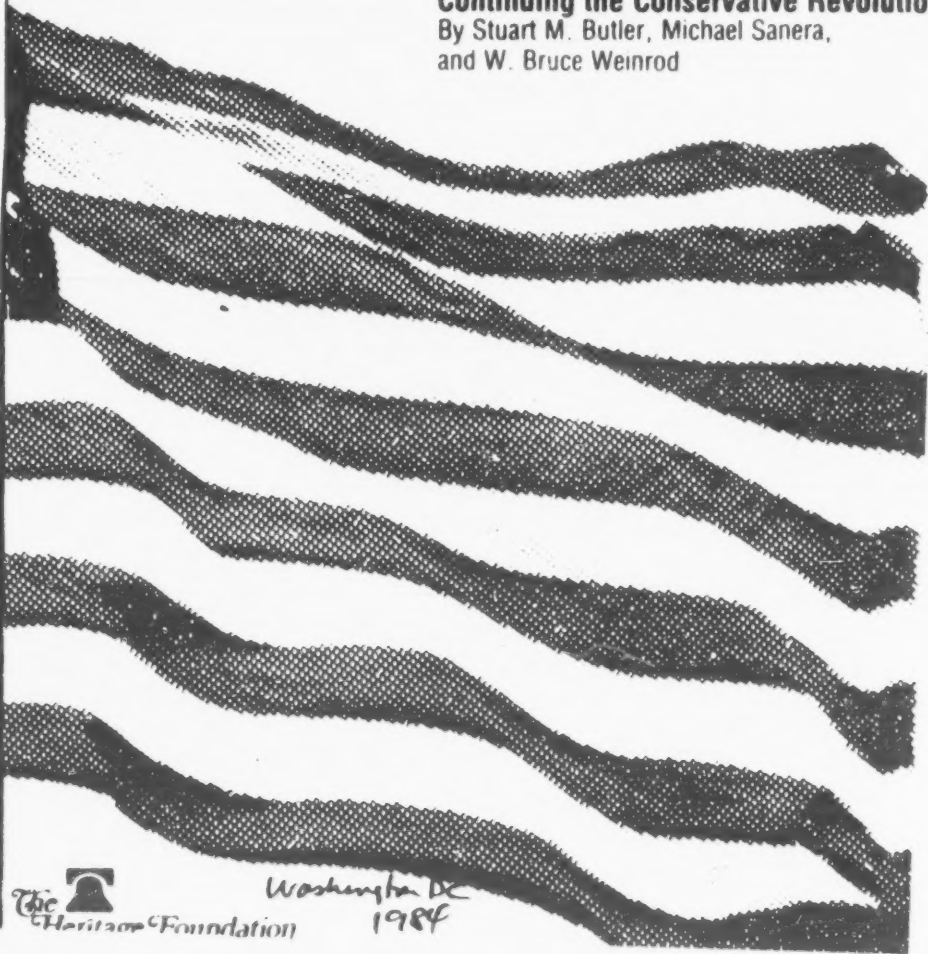
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# MANUAL FOR LEADERSHIP II

Continuing the Conservative Revolution  
By Stuart M. Butler, Michael Sanera,  
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The Heritage Foundation

Washington DC  
1984



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## Defense Assessment

by  
Theodore J. Crackel\*

### Introduction

An effective U.S. defense capability has two essential components: forces (weapons and personnel) and procedures to assure the most effective and cost-efficient development and implementation of U.S. strategy and tactics. In the first area, the Reagan Administration orchestrated implementation of a program of force modernization and associated spending increases essential to reverse a near decade-long decline in defense capabilities. An immediate budget supplement in 1981 and a subsequent growth in spending—though reduced substantially by the Congress—has reversed that trend.

The next step is for a new administration to implement changes in defense procedures and organization so as to improve the effectiveness of the dollars spent. These changes, however, should not get in the way of continuing the necessary modernization of U.S. forces.

With respect to process, the Reagan Administration has implemented some decentralization within the Department of Defense (DoD). But an emphasis on decentralization of program execution should not be allowed to obscure the necessity of sure, central direction and guidance in the areas of policy/strategy formulation and resource allocation.

To date, the emphasis on central direction has been in the area of resources. Resource allocation and budgeting have been the main instruments of control. To improve effectiveness, the Reagan Administration has revamped the Defense Resources Board (DRB) and has

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\*The author wishes to acknowledge the very significant contribution of all those who shared their ideas with The Heritage Foundation's Defense Assessment Project. The paragraphs on Defense Acquisition and Logistics, specifically, were written in close coordination with E. X. Livingston who chaired that working group. Particular thanks also go to all the project's working group chairmen, members, and to many others, including: Henry Young, Mackubin T. Owens, Henry Mohr, Carnes Lord, Donald W. Hurta, Robert K. Griffith, Mike Sovereign, Walter Jajko, J. A. Stockfisch, C. J. Tringali, Patrick L. Renchan, David Westerman, Richard D. Webster, C. Lincoln Hoewing, and John A. Mullett.

made some tentative modifications to the budgeting system. This emphasis on resources and budgeting, however, has come at the expense of policy influence. In fact, the military Services are controlled more by the budgeting process than by carefully articulated defense guidance or strategic designs.

The role and influence of the policy formulators must be expanded. Policy and strategy guidance and the mechanisms to produce them must be enhanced or created at every level in the national security apparatus—from the National Security Council to the Joint Chiefs of Staff.

While substantial progress has been made in force modernization in the last four years, more now needs to be done to fix the way America does its defense business and spends its defense dollars. An emphasis on resources can improve the way weapons systems are purchased. An emphasis on policy and strategy can improve the quality of the decisions about what to purchase. Both are essential. Today the influence of policy needs to be brought into balance with the already established emphasis on resources.

### National Security Council

When President Reagan took office, there was general agreement to limit the role of the National Security Council Staff and return to a "cabinet government" model for managing the national security process. The Administration in general has accomplished this.

Today, there are three separate but related roles for the NSC and its staff. First, the NSC is an agency for policy coordination. Second, the NSC represents and protects the interests of the President and the integrity of presidential or national-level policy. Finally, the NSC must monitor the formulation and execution of national security policy and enforce overall discipline on the system itself.

Of these three functions, the first has been performed best by the Reagan Administration; the last needs considerably more emphasis. A fundamental error was the decision to transfer from the NSC staff to the agencies the right to chair the inter-agency committees that form the body of the NSC system, such as groups dealing with the Strategic Arms Reduction Talks (START) or conventional force enhancement. It has complicated and impaired the performance of all three NSC functions, but especially the latter two. While some committees indeed have been created under the chairmanship of the National Security Advisor or his staff—including crisis management, technology transfer, and continuity of government—policy formulation in such vital areas as national security continues to be dominated



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by the agencies themselves. The result has been enhanced institutional resistance to fundamental policy changes, and incoherence and inefficiency in the overall policy process.

The NSC may be weakest in its most critical function, the formulation and execution of national security policy. To a degree this is so because it has no faculty for formal, long-range planning. Moreover, there is no inter-agency organization whose specific duty is to identify U.S. national security objectives, formulate the broad strategic designs, and coordinate planning relative to the political, military, economic and other instruments of national power.

## Department of Defense

There is ample evidence that the Administration has given serious thought to some fundamental difficulties in the department. Both acquisition and the budgeting process were early targets for change.

Deputy Secretary of Defense Frank Carlucci (and later Paul Thayer) championed a series of acquisition initiatives aimed at bringing order to that process. At the same time, revisions in the Planning, Programming, and Budgeting System (PPBS) were drafted that would put more emphasis on planning and bringing budgets more in line with objectives, policies, and strategies.

Both efforts have fallen far short of their objectives and one reason is the illogical organization of the Defense Department, which sanctions and perpetuates institutionalized parochialisms. These, in turn, are expressed in the programs, forces, and systems of the Defense budget, despite the fact that they may not necessarily constitute the most effective, imaginative, or economical response to the military threat that faces the nation. The current Defense organization also encourages frequent congressional interference and reinforces the kind of advocacy that leads to an inefficient division of both resources and military roles and missions. Creating a more efficient defense structure requires tempering the role of these advocates, placing a new emphasis on policy guidance, and fixing the budgeting and acquisition processes.

## Office of the Secretary of Defense

The Department of Defense, and in particular the Office of the Secretary of Defense (OSD), is poorly organized to do its job of

preparing for or conducting combined warfare. OSD organization is overly complicated, and, as a result, often inefficient. That it functions at all is largely due to the Herculean efforts of its civilian and military officials. Some expressions of this poor organization are the Secretary's unwieldy over-extended bureaucratic span of control, an illogical division of responsibilities, excessive staffing in the decision making process, and constant conflict over division of labor within and among components.

Currently, two Under Secretaries, a dozen serving Assistant Secretaries (plus, a roughly equal number of others of comparable rank), three Service Secretaries, the Chairman of the Joint Chiefs of Staff, nine field commanders, and a host of Defense Agency heads have the right to report directly to the Deputy Secretary and the Secretary. The plethora of officials reporting to the Secretary must be reduced.

A beginning point would be to reduce the host of current official titles in OSD. In addition to the Under Secretaries and Assistant Secretaries provided for by law, there are Assistant Under Secretaries, Deputy Under Secretaries, Assistant Deputy Under Secretaries, Deputy Assistant Secretaries, and Principal Deputy Assistant Secretaries. These, of course, are in addition to the Assistants to . . . , the Deputies to Assistant to . . . , and the Executive and Special Assistants to . . . Intra- and inter-agency coordination is made unnecessarily difficult by this arrangement.

Next, OSD's functions should be rationalized. Today functions and responsibilities are split (or sometimes shared) by separate chains of command. For example, the Assistant Secretaries of International Security Policy and International Security Affairs (titles that do more to confuse than to clarify the differences in their roles) have divided formerly conjoined geographical responsibilities. There is a Deputy Assistant Secretary for Europe and the Soviet Empire working for one of the Assistant Secretaries, while the rest of the world's regions have been placed under the other. Given the complexity of today's world, this unnecessarily complicates coordination. Nuclear forces have been similarly divided from general purpose forces for inexplicable reasons but with predictable results. Other areas, such as intelligence and logistics, have been artificially divided between the Under Secretaries.

Congress often has been tempted to "help" the Secretary in this area by legislating organizational arrangements. That "help" has almost always been counterproductive. A better tack would be to allow the Secretary of Defense even broader latitude to organize his office and to make it most responsive to his direction.

*Planning, Programming, and Budgeting*

Dozens of in-depth, government-sponsored studies during the last 20 years, reinforced by sharp criticism from many retired senior officials, suggest that the present organization of the flow of work in national security planning is not adequate.

Too much of today's defense management is based on a Planning, Programming, and Budgeting System (PPBS) established in the early 1960s. It is through this device that the Office of the Secretary of Defense really controls the Pentagon.

The process begins in January with the release of the Secretary's "Defense Guidance." This contains an estimate of security threats and opportunities; a brief review of national and military policies and strategies by region and priority; and other major issues including needed, high-priority combat and support capabilities. The Services, with advice from the commanders of the combatant commands (CINCs), then proceed to formulate their individual program and budget requests for the upcoming five-year period—the Program Objective Memoranda (POMs). In May the POMs are forwarded for approval to the Defense Resource Board (DRB) composed of the principle OSD officials, the Service Secretaries and the Chairman of the Joint Chiefs of Staff.

During the summer, the DRB intensively reviews the several Service and Defense Agency POM submissions. DRB decisions are then returned to the Services or Agencies to be worked into a five-year budget and then later consolidated into a Pentagon Five-Year Defense Plan.

This system has several deficiencies:

- Throughout the PPBS process, the commanders, who use forces, and the Joint Chiefs of Staff, who are responsible for preparing joint strategic plans for global warfare, function only in an advisory capability. The providers—not the users—make the decisions.
- Several critical decision-making steps—strategy formulation, requirement analysis, and other steps to operating the forces—lay outside the PPBS process.
- The influence of the Services and Agencies on resource allocation far outweighs that of the joint staff and CINCs. The central responsibilities for integrating policy and resources—coordinating the efforts of all the principal actors—are short-circuited.

These long standing deficiencies in the defense management system strongly suggest that, in addition to obvious structural reforms, the

programming and budgeting responsibilities of the Services and Agencies should be revised fundamentally. Defense budgets should be shaped by plans that implement strategic designs, not by parochial service interests or bureaucratic politics.

Policy guidance from the Secretary must be brought into balance with resource interests. A Defense Policy Board (DPB) should be established to highlight the Defense Guidance and other policy outputs. It should be headed by the Under Secretary for Policy and constituted similarly to the Defense Resource Board (DRB). The DPB should determine such defense policies as regional and global politico-military missions, the utilization of forces, broad force employment guidance to include the employment of nuclear weapons. These essentially are the "political" decisions relative to the employment of forces.

These "policy" decisions will guide military strategy formulation by the Joint Chiefs of Staff and the Joint Staff, and derivative planning in the combatant commands.

Following this strategic and operational planning, the responsibility for requirements analysis—detailing the resources needed to implement the plans—falls naturally to the Services and agencies are charged to train, equip and support the forces. The resource requirements derived by the separate Services, should then be forwarded to the Joint Chiefs of Staff, where they would be reconciled with joint plans and strategy. Consolidated requirements would then be sent to the Defense Resource Board for approval. In sharp contrast to today's procedure, this Defense Resource Board (DRB) will debate consolidated resource requirements derived from plans prepared by the operators, not the separate Service requirements generated by programmers.

### **The Joint Chiefs of Staff**

Today the Joint Chiefs of Staff (JCS) organization suffers some critical deficiencies and the very limited reforms enacted in 1984 did little to mitigate them. The JCS, as a body, is seen by many civilian leaders as either unable or unwilling to provide useful advice on tough issues. Joint Staff work comes across as superficial, predictable, and of little help in resolving issues.

Several problems are particularly acute. First, the planning and the formulation of national military strategy that should occur in the joint arena is wholly inadequate. The individual military Services have clear views, but some coherent joint military view has been conspicuously absent. Second, the allocation of Service roles and missions is a

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function that the current organization essentially has abdicated. Last, as discussed above, the JCS plays no meaningful role in the resource allocation and budgeting process.

The roots of these problems are organizational; they lie in the inherent weakness of the joint structure and the overwhelming influence of the separate Services. Some of the weaknesses of the JCS are self-imposed. The Joint Chiefs have agreed to act only in unanimity, but unanimity is hard to achieve. Service parochialism is as ubiquitous as it is legendary, and the Services, which the Chiefs individually represent, cooperate only grudgingly. Often the wording of advice or recommendations that all the Services finally will endorse is so innocuous that it has little value—the fabled “common denominator” advice.

## *Strategy Formulation*

The current U.S. approach to strategy formulation is a prime example of this difficulty. It implies, through the necessity for consensus, a belief that sound intellectual arguments will convince even the most stubborn Service devotee. In fact, good arguments seldom win out when people and organizations seek foremost to protect their own visions and organizational “turf.”

The Joint Chiefs of Staff and their Joint Staff are tasked by law and by Department of Defense directive to develop strategies and contingency plans that require unified strategic direction. Yet, the JCS and the Joint Staff have not been an effective force in strategy planning. The reason is that the individual Services dominate the joint process. Today the Army, Navy, Air Force and Marine Corps vie with each other for the resources necessary to carry out their own Service-centered strategies. Each is convinced that its forces and capabilities are the most important in attaining the nation's objectives. Beyond the goal of deterring nuclear war, the Navy has pressed for a Maritime strategy, while the Army has put forward a Continentalist approach in which its forces would play a more central role. Both compete with the Air Force's strategic air power interests. The prize is the resources that would allow them to shape forces in molds of their individual making.

This situation is unsatisfactory. American military strategies must be based on an evaluation of the nation's interests and objectives—and the threats to those interests and objectives. Military strategy formulation should be handled by the Joint Staff, in coordination with the commanders of the combatant commands (CINCs) and Services. Subordinate operational plans should be developed by the CINCs and approved by the JCS. Only then can decisions be made



about the force structure—the way the Services organize to fight. Each Service has unique characteristics and capabilities that must be considered and carefully orchestrated in the development of these strategies. By definition, such unified actions means overcoming the parochialism inherent when individual Services develop the strategic concepts. This means the creation of a stronger joint structure.

General John Vessey, the Reagan Administration's Chairman of the Joint Chiefs, has instituted some changes, but a conflict of interest persists between the Joint Staff and the Service staffs in such key areas as force planning and resource allocation. Efforts, for example, by the new Joint Special Operation Agency to influence (or even monitor) the development of special operations forces have been simply rejected by the individual Services. It is clear that before coherent strategy choices can be made, structural and organization reforms will be required to strengthen the joint system relative to power of the Services. This will require legislation.

### *Roles and Missions*

The current assignment of roles and missions to the various services dates back to agreements reached shortly after World War II. New technologies and techniques, however, blur the distinctions. The Army, for example, with its growing number of attack helicopters has usurped much of the close-air-support role from the Air Force. Longer range Naval aircraft, meanwhile, have invaded the manned strategic nuclear bomber role that the Air Force long assumed was its own. Such confusion of roles leads to duplication and redundancy.

Mission definition is equally inadequate. Incongruous boundaries between commands—unified and combined—inevitably lead to inefficiencies and possibly to disaster. Services want missions because they bring increased resources and career opportunities. The JCS, not surprisingly, has proved incapable of altering established role and mission allocations or in making new ones—except to allocate some part of new missions to each Service. Often cited as examples of this are the ill-fated Iranian and the successful Grenada rescues. The solution was, in each case, to assign some role to each Service—despite inadequate joint doctrine or even the ability to communicate effectively. The inability of the JCS to develop a coherent strategy for force employment into Southwest Asia, should such action become necessary, unfortunately is typical of the inadequacies in the current system.

This has led to a rather *ad hoc* force structure based on each Service's independent reading of strategy design and associated roles and missions.

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The "ecumenical" approach to defense has other unfortunate effects. When all the Services must be allowed to participate in every operation, the predictable result is overlapping missions and duplication of effort. Each of the Services has special operations forces—and some, like the Army, have several breeds. Each of the Services has its own separate "air force," and in the Air Force itself there are at least three.

The U.S. cannot afford the confusion and duplication inherent in this situation. The military may always have some duplication of capabilities, but there is little excuse for duplicating roles and missions. A new process of assigning roles and missions is required.

Roles and missions should be derived from national military strategies and prescribed joint doctrine; it must be a top down approach. This requires the strengthening of the organization charged with formulating military strategy and joint doctrine—the Joint Staff.

The Joint Staff must be capable of resisting the power of the individual Services. It must be sufficiently independent to be able to insist that, when the situation dictates, an operation can fall fully under the purview of a single Service. That the Marines, for example, with their associated Navy support, could be made responsible for an entire operation; that the Army and Air Force need not play any direct role.

## Reorganization

A main cause of the Joint Chiefs of Staff problem is widely acknowledged to be the juxtaposition of a weak joint staff system and strong Service Departments. "The present system," reported a 1978 Defense Department study of the military command structure, "makes it difficult for the Joint Staff to produce persuasively argued joint papers which transcend Service positions."<sup>1</sup>

The lack of influence of the JCS is an institutional problem. Its insistence on unanimity makes the system a prisoner of any one of the Services. General David Jones, a former Air Force Chief and then Chairman of the Joint Chiefs, illustrated the problem for the House Armed Services Committee. "For a substantive paper of some length, each Service action officer may have as many as 100 recommended changes. They quickly learn the art of compromise—each agreeing to support the balance of the changes proposed by the other in return for equal support. . . . In sum, the current Joint Staff process encourages compromise, relies too heavily on Service participation, and depends on staff officers who are well versed in Service interests, but are ill

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<sup>1</sup> Richard C. Steadman, *National Military Command Structure [Study]*, July 1978.



prepared to address issues from a joint perspective."<sup>2</sup> The only member no longer beholden to a Service is the Chairman, but he has little independent authority and few resources upon which to draw. The Joint Staff does not even work for him.

At the top, the Chiefs are expected to make decisions for their Service wearing one hat, and then, wearing another, sit in judgment of them. JCS advice on budget matters is a good example. Service pressures are so great that the Chiefs are seldom able to give up popular Service programs. As a result, they cannot set the priorities that could produce a less costly but equally effective defense budget.

Service strategic thinking is motivated more by competition over constrained defense resources than by clear-headed strategic analysis. Bureaucratic politics and parochial service concerns dominate the JCS process.

A 1970 Blue Ribbon Defense Panel concluded that JCS unanimity in recommendations and advice was more often evidence of accommodation of all Service views than of tough, objective thinking. The roots of this Service parochialism, the report found, lay above all in the fact that staff officers' careers were so closely tied "to the prosperity of their Service."

The situation has not improved since that study. Because of its structure, the Joint Chiefs often cannot deal realistically with issues that affect Service interests. These are matters of fundamental importance to national security: the formation of military strategies; the allocation of resources to various defense missions; the assignment of geographical and functional responsibilities among the field commanders; roles and missions of the services; and joint doctrine and training.

Through the years, a number of studies have addressed this problem and have made strikingly similar proposals. Virtually all have recommended strengthening the role of the Chairman of the JCS and of the Joint Staff. This action is long overdue. Only organization change will shift the emphasis from inherent Service interests to essential joint performance. The Congress took some very tentative steps in this direction in 1984 but has not gone nearly far enough. Both houses have pledged to take up again the issues of JCS reform and comprehensive DOD organizational reform with the intent of enacting legislation in 1985.

Most of what could be fixed in the "jointness" arena under existing authority of the President or Secretary of Defense has been attempted, with little effect. The Administration, therefore, should encourage

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2. General David C. Jones. Written responses to staff questions. "1982 House Hearings on JCS Reorganization." [H.A.S.C. No. 97-47] p. 95.

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immediate congressional action to strengthen the role and voice of the Chairman, the Joint Staff, and the combatant commands.

## The Service Secretariates

The power and traditional independence of the separate military departments is steeped in U.S. tradition and has its merits. Yet it also makes joint planning very difficult. The current separate department secretariate structure allows circumvention of directives or issues that might work to an individual Service's disadvantage. The Service Secretaries, at the behest of their military leadership, can and often do take such issues around the JCS to the Secretary of Defense, or even around the Secretary to the President or the Congress. Given the political dynamics of the Washington policy process, Congress even encourages such action, allowing a congressional faction and a Service to champion each other. Paradoxically, the more effective the Service Secretaries are, the more difficult cooperation in the joint arena becomes.

Problems created by the Service structure were addressed by the President's Private Sector Survey on Cost Control—the Grace Commission. "Many organizations," it reports, "perform similar functions" throughout the Pentagon. The Commission cites "a number of managers who argued persuasively that the staffs reporting to the Service Secretaries are anachronisms, left over from their days of Cabinet rank. . . ." The Commission recommends "the elimination of the staffs reporting to the Service Secretaries" and the "creation of a Defense Executive Office to include the Secretary of Defense, the Service Secretaries, the Chairman of the JCS, and the Deputy Secretary of Defense."<sup>3</sup>

A number of studies of the role of the Service Secretariates have been conducted, and most have concluded that the Secretaries can play an important role, but that they must be absolutely loyal to and reflect the policies of the Secretary of Defense in addition to championing Service positions.

Extraordinary efforts on the part of the current Service Secretaries and Chiefs have produced two groundbreaking memoranda identifying some limited areas of interservice cooperation. The nation, however, cannot afford to rely forever on such extraordinary efforts. The structure must be altered to facilitate the joint process. The Grace Commission proposal is a step in the right direction and is consistent with the need to retain the Service Secretaries and link them more closely to the Secretary of Defense.

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3. President's Private Sector Survey on Cost Control, *Report on the Office of the Secretary of Defense*, Spring-Fall 1983, pp. 34, 37.

## RECOMMENDATIONS

### *National Security Council*

The Administration should:

- Strengthen the role of the NSC staff in the inter-agency process.
- Create a new senior inter-agency group to identify national objectives, formulate national strategy, and coordinate its planning.
- Create a long-range planning group within the NSC staff to support this latter effort.

### *Office of the Secretary of Defense*

The Administration should:

- Reduce the position titles within the Office of the Secretary of Defense to Secretary, Deputy Secretary, Under Secretary, Assistant Secretary, and Deputy Assistant Secretary. All others should be "Assistants to" these officials.
- Reduce the span of control of the Secretary of Defense. The Service Secretaries and the Chairman of the Joint Chiefs of Staff must report to him, and the General Counsel, the Assistant Secretaries for Legislative Affairs, Public Affairs, and Comptroller have unique functions that require that they also should report directly. Others, however, should report through two Under Secretaries—one for Policy and one for Resources.
- Rationalize OSD's functions in light of the recommendation above. The Under Secretary for Policy should coordinate Regional Affairs (to include Security Assistance); Nuclear Policy; Defense Intelligence; Security Affairs (including technology transfer); Reserve Affairs; and Strategic Defense. The Under Secretary for Resources should coordinate Defense Research; Acquisition Management and Logistics; Mobilization Management; Manpower; Command, Control and Communication; and Requirements, Test and Evaluation Policy.
- Create a Defense Policy Board (DPB), to produce the Defense Guidance and other political-military policy outputs. It should be headed by the Under Secretary for Policy and constituted similarly to the current Defense Resource Board.
- Restructure the current budgeting process in order that programming and budgeting by the Services and Agencies is: (1) guided by

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requirements for weapons, support systems, forces, and manpower identified by the combatant commands; (2) reviewed and consolidated by the Joint Staff; and (3) approved by the Defense Resource Board. These requirements must reflect both the Defense Policy Board's guidance, and the strategies and plans prepared by the uniformed Joint Staff and field commands.

### ***Joint Chiefs of Staff***

The Administration should:

- Strengthen the role of the nation's senior military officer and provide him with a four-star deputy. The Chairman of the Joint Chiefs of Staff should: (1) be authorized to give military advice in his own right to the President, National Security Council and the Secretary of Defense; (2) "supervise" the combatant commands in addition to acting as their "spokesman"; (3) be placed expressly in the national military chain of command; (4) manage the Joint Staff on his own behalf; (5) select officers for assignment not only to the Joint Staff but also to all joint billets; (6) recommend to the Secretary of Defense the promotion (in their service lines) of fitting officers occupying joint billets.
- Strengthen the Joint Staff by: providing that it work for the Chairman (and not the corporate JCS); by enlarging it in accordance with its enhanced role; and by insuring that officers serving on the Joint Staff continue to return to the field at regular intervals for assignment to either Service or joint billets.
- Assign the Chairman of the Joint Chiefs of Staff, the responsibility for formulating military strategies keyed to the political-military policies and objectives articulated in the guidance formulated by the new Defense Policy Board and issued by the Secretary of Defense.
- Assign the Chairman of the Joint Chiefs of Staff the responsibility for allocating Service roles and missions based on guidance of the Defense Policy Board and the military strategies developed from it.

### ***Service Secretariates***

The Administration should:

- Create a Defense Executive Office, as recommended by the Grace

Commission, containing the Secretary of Defense, the Service Secretaries, the Chairman of the Joint Chiefs of Staff, and the Deputy Secretary of Defense.

- Assign the Service Secretaries a larger role in assisting the Secretary of Defense as the Secretary's primary advisors on Service matters.
- Insure that presidential nominations to all positions in DoD (including the Service Secretaries) are reviewed by the Secretary of Defense.

\* \* \*

### Defense Acquisition and Logistics

With the key modernization programs in both the strategic and conventional arenas well underway, the Secretary of Defense must now personally undertake a new effort to make significant cost and performance improvements in the acquisition process and the bureaucratic culture within which it operates. The nation must move beyond the volatile and dangerously unpredictable defense spending cycles of the past.

The United States has chosen to rely on technological superiority, but that edge must be real, not just theoretical. In an era when major weapon system development—from concept to fielding—often takes fifteen years or more, and when the effective life of key technologies comes in three to five year cycles, the U.S. appears to be approaching the point when systems will be increasingly outdated even as they roll off the assembly lines. With Soviet weapon system development on a substantially shorter cycle, the U.S. technological edge might soon be in jeopardy.

Virtually every study on the acquisition process in the last ten years has come to the same conclusions. The U.S. must:

- Establish program stability.
- Install realistic budgeting and cost estimating.
- Improve weapon system availability (or readiness) and the ability to support those systems.
- Make capabilities match planned performance.
- Make contracting more effective through multi-year procurement, competition based on quality, and economic rates of production.
- Make managers and companies accountable for their actions, decisions, policies, and contracts.

These are likewise the conclusions of this study and also are found



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in the acquisition initiatives sought by the Reagan Administration. This latter effort, however, has not proved particularly effective. The problem is not what to do—here there is much agreement—but how to do it. All of the functional elements of the process must be attacked simultaneously, and borrowing from the military lexicon, the principle of mass must be observed. This principle indicates that overwhelming force should be applied at the critical points and at the critical moment. This “mass” can only be created by the Secretary of Defense; lesser forces are demonstrably inadequate. The history of DoD suggests that real reform requires the concerted effort of the Secretary himself.

Five phenomena—five points of attack—are key to any reform of the system:

- Acquisition Policy;
- Organizational Structure;
- Management Information Systems;
- People Policies; and
- Acquisition Strategies and Contracting.

### *Acquisition Policy*

Current Pentagon acquisition policies are confusing, time consuming, and costly. For example, the “milestone” approach has created the misconception that there is some point when research, developmental engineering, test and evaluation (RDTE) is completed and when production begins. This has led to ill-advised rules dictating that “production funds” cannot be expended before a particular milestone, or that RDTE funds will not be authorized afterward, or that production lines will be established only with production funds. The fact is that money needs to be spent on producibility engineering, manufacturing planning, tooling, and maintenance and test equipment from the start. New guidance is needed to insure that funds for these activities are available early in the process. Some projects might be scrapped after early production money was spent, but the savings in both time and money on the majority would far offset any losses.

### *Organizational Structure*

The functional elements of the acquisition and logistics process are currently misaligned. For example, combining Research, Development, Test and Evaluation creates internal contradictions and diametrically opposed objectives. The basic acquisition functions should be realigned as follows:

- **Requirements Identification, Test and Evaluation.** The agency that defines the functional requirements should play a key role in insuring that they are met in the final product.
- **Research.** "Research" is linked by habit with "development"—the term "R&D" is ingrained. Research, however, is most effective when freed from specific development and "development" is better treated in train with "production."
- **Development; Production; Acquisition Logistics.** Hard experience reinforces the notion that production considerations need to be treated early in the development process. The same is true of logistics or considerations of reliability, availability and maintainability.

The current Pentagon organizational layering causes repetitious staff program reviews. This must be minimized. This means increasing staff accountability at some levels, particularly in the planning phases, while reducing staff interference in others. A better management information system would reduce the need for so many reviews.

### *Management Information Systems*

Today numerous data bases are used by managers throughout the Pentagon, with little interaction among them. It is a near certainty that what emerges as total costs or unit costs (or any other specific factor) for any given program will differ markedly from one data base to another. To develop clear audit trails, to ensure that adequate resources are committed at the time of a decision, and to force cost discipline in the process, the various data bases must function as a single system. Changes in one parameter must automatically trigger the appropriate responses in all affected areas. An effective management information system must become a high priority.

### *People Policies*

Acquisition management is one of several areas in which personnel policies must be revised so they do not discourage highly qualified people from seeking Pentagon careers. Military officers must be allowed to specialize at mid-career. Uniformed project managers average less than three years in their positions, and many come to the jobs with no prior experience in that field. The longer tours prescribed in legislation in 1984 are desirable, but a strong professional background in acquisition management is even more essential. After some ten or fifteen years' service, after having qualified in an entry spe-



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cialty, and after demonstrating an aptitude for acquisition management, selected officers should be invited to specialize in that area and assigned to work in that field for the balance of their careers. They should not suffer significant career penalties for doing so.

More also needs to be done to attract successful mid-career corporate executives and professionals to temporary government service. Current rules requiring divestiture of stock holdings in defense industries should be modified to provide roll-over into other investments without tax penalty. Under today's rules, a successful executive and wise investor could pay as much in capital gain taxes as he would make in a government salary, simply for the privilege of serving the country.

### *Acquisition Strategies and Contracting*

Competition is the key to changes in the acquisition process, but competition should be based on quality. Today's system focuses on price. There is even a "best and final" bidding process through which prices are auctioned down. The net results are lower quality and artificially low prices that firms expect to raise in the process of the inevitable contract changes.

The objective should be to create a "competition culture" built around quality, and effective, "win-win" concepts of business. To do this the concept of "profit" must be shifted from one based on a percentage of cost, to one based on a realistic return on investment. At the same time it must be recognized that there are cases where competition can be effectively initiated only at the sub-contractor level. Market forces, allowed to operate in an environment as free of regulation as possible, are the best insurance of an effective, competitive contract process. The new Federal Acquisition Regulations (FAR) establish such an environment. They are much less detailed than the older guidelines and their utilization will require professional growth in the acquisition and contracting community. That growth needs to be fostered and encouraged. The opposite, in fact, seems to be taking place. The Services are beginning to encumber this process by attaching their own more extensive set of "interpretations." These add an unnecessary layer of regulation and should be abolished.

## RECOMMENDATIONS

### *Defense Acquisition and Logistics*

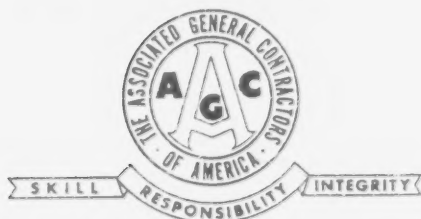
The Administration should:

- Revise Department of Defense Directive 5000.1 to state explic-

itly that approval for full scale development carries with it the authority to program and obligate funds for critical production engineering and associated activities.

- **Realign the organizational structures—both at the policy-making and execution levels—to reflect new functional linkages:**
  - Requirement Identification; and Test and Evaluation.
  - Research.
  - Development; Production; and Acquisition Logistics.
- **Reduce the level or number of program reviews.**
- **Install an effective and interactive Information Management System and make it the sole source of program and budget data.**
- **Install personnel policies that encourage competent professionals—from the military services and from the private sector—to seek appointments to careers in defense acquisition management without incurring excessive career or financial penalties.**
- **Revise acquisition policies to encourage: competition based on quality instead of cost; and profit based on return on investment instead of cost.**
- **Fully implement the new Federal Acquisition Regulations (FAR) in Defense by: encouraging professional growth among defense contracting personnel to allow them to work in an environment more free of detailed regulation; and discouraging the individual Services from issuing their own more detailed “interpretations” of the FAR.**

Statement of  
The Associated General Contractors of America  
Presented to  
Subcommittee on  
Oversight of Government Management  
United States Senate  
Governmental Affairs Committee  
on the Topic of  
The President's Private Sector Survey  
on Cost Control  
February 13, 1985



AGC is:

- \* More than 32,000 firms including 8,400 of America's leading general contracting firms responsible for the employment of 3,400,000-plus employees;
- \* 109 Chapters nationwide;
- \* More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utilities facilities;
- \* Over \$100 billion of construction annually.

AGC is pleased to offer comments regarding the President's Private Sector Survey on Cost Control (PPSS). AGC participated in this effort by working with the Federal Construction Management Task Force. This Task Force identified several of the issues and cost saving recommendations that were also identified by the Procurement Management Task Force which this Committee is now examining. AGC believes that the following three recommendations merit special consideration, particularly as they affect the construction industry.

Lessen the Impact of Socio-Economic Programs on the Acquisition Process - One of the Federal Construction Management Task Force's key findings is that requirements unrelated to efficient construction have been imposed by the Federal Government on its construction programs. These requirements include the Davis-Bacon Act and the set-aside programs for small and small/disadvantaged businesses. These requirements have hampered effective program management and increased costs in a variety of ways.

Regarding the Davis-Bacon Act, the Construction Management Task Force deferred to the Labor Department Task Force which made the following recommendation:

"A study of the issues confirmed that the Davis-Bacon Act significantly raises the cost of public construction. The study also confirmed that the Act is not, and cannot be, fairly and effectively administered. As such, the Davis-Bacon is inefficient on economic grounds and its continued application is not adequately supported by the arguments offered in its support.

The Act adds in the range of \$1 billion to \$2 billion in additional costs to Federal and Federally-assisted construction annually, or an average of \$1.5 billion a year. The three-year savings to the Federal Government, with a 10 percent annual inflation estimate, would be \$4.97 billion without Davis-Bacon. The Davis-Bacon Act should be repealed."

In addition to PPSS findings, there are well-documented studies by the Wharton School at the University of Pennsylvania ("Davis-Bacon Act," 1975), the General Accounting Office ("The Davis-Bacon Act Should Be Repealed" HRD-79-19), Oregon State University ("Effect of the Davis-Bacon Act on Construction Costs in Non-Metropolitan Areas of the United States," January 1982) which have found that the Davis-Bacon Act inflates federal construction costs by several hundred million dollars a year.

AGC's policy is that the Davis-Bacon Act should be repealed. That recommendation has been made to the Grace Commission, several Administrations and Congress on numerous occasions.

The Federal Construction Management Task Force reported that the small business set-aside program, 8(a) set-aside program and the minority business subcontracting program add an estimated 1.2 percent annually to Federal construction costs. Administrative costs could not be determined due to the limited time in which the Task Force had to prepare its recommendations. The Task Force strongly recommended that a cost/benefit study be completed by the GAO to more closely examine these programs.

AGC endorses an overall study of the cost and impact of these programs in the construction industry. Other studies indicate that the increase in Federal construction costs is far in excess of 1.2 percent. The small business set-aside program, for example, has significant increased costs to the government and the taxpaying public. A 1976 report of Consultants to the Chief of Engineers (Army Corps of Engineers) on small business set-asides (dredging) found the following "...the low bids received under unrestricted advertisements were nine percent lower than those received under set-asides..." AGC has identified examples of 8(a) contract awards that show increased costs to the government from 15 to 55 percent. In 1979 a GAO study of a minority business subcontracting program established by the Local Public Works Act of 1977 found that "Price quotes of minority firms averaged about nine percent higher than normal prices." This report also indicated administrative costs and other costs were significant as they relate to these programs.

Construction is a free market industry based on the open, unrestricted competitive bid system. Special preference procurement programs undermine this system and unquestionably cost the taxpayers more. AGC recommends elimination of these programs in construction procurement.

#### Encouraging Contracting Out of Activities to the Private Sector-

AGC supports the National policy that government should not compete with the competitive free enterprise system and should rely on that system for the goods and services it requires. This policy is articulated in OMB Circular A-76 which requires federal agencies to do cost comparisons prior to initiating a commercial activity. However, the Construction Management Task Force found that "Executive Branch agencies are effectively limiting

the intended impact of OMB Circular A-76 by claiming numerous exemptions, and preparing inaccurate cost comparisons. This situation is perpetuated by the fact that the agencies themselves initiate all such decisions and analysis." To overcome these shortcomings in the A-76 cost comparison analysis the Task Force suggested that this responsibility be transferred to OMB and that legislation be enacted to strongly reassert this national policy.

AGC recommends that legislation be enacted that prohibits the use of force account construction with federal funds. AGC also recommends that the legislation extend the A-76 provisions to federally-assisted construction which is funded through grant programs. The taxpaying public has the right to have its funds spent in the most efficient and economical manner possible on all federally-funded construction projects. The distinction between federal and federally-assisted construction programs should not be a reason to deny this guarantee.

In addition to the cost savings which are initially received by the federal government by contracting out, long range cost savings will also result. Many of the construction projects completed with government employees are of size and complexity for small, emerging businesses, including those owned by minorities. Performance of these projects by public agencies forecloses important growth opportunities for emerging small firms. Because of low overhead costs these small firms are very cost competitive. Construction by force account of these small and medium size projects denies small firms the opportunity to compete in this market.



It is paradoxical that special preference procurement programs are being widely used despite their economic and special costs, when so much good could be done by providing contracting opportunities through free and open competition to thousands of firms. Long range savings could accrue to the government by eliminating the costs associated with the socio-economic programs and reaping the lower costs of construction resulting from contracting out.

Enhancing Competition in Contracting Through the Use of Functional or Performance Specifications - AGC disagrees with the recommendation by the Construction Management Task Force that functional specifications be used in connection with Federal construction procurement. Such a system allows for the procurement of construction services stated in terms of an agency's needs. AGC opposes this concept because it will reduce competitiveness in the construction industry and thereby increase costs.

Use of functional specifications, thereby eliminating the requirement for formal advertising, is a proposed solution to a problem which does not exist in construction procurement. The overwhelming amount of construction procurement is formally advertised, competitively bid. Since each construction project is unique and built to order, precise specifications, terms and conditions are needed. Construction procurement is different from the procurement of shoes, pencils, hardware, software systems and weapons.

Despite the historical success of the open competitive bid system with single contract award to the lowest responsible bidder, we have seen, throughout the years, attempts to tinker with this proven method; attempts to apply procurement techniques that may be appropriate in other, less competitive industries, to construction procurement. While these so-called

"innovative" methods have never proven successful in construction procurement, the attempts to force their application seem never ending; for example, the effort to apply the Office of Management and Budget Circular A-109, the Major Systems Acquisition Regulation, to construction procurement. This 1976 Circular provides for the use of "functional specifications", in procurement with the federal contract awarding agency using subjective evaluations to select the proposal among many different ones submitted as solutions to a vaguely defined procurement need. The application of this concept to construction procurement would place undue emphasis on, and give preference to, construction firms with developer or consortium capabilities--characteristics not generally found in the average small business construction firm. It would also do so at the expense, and perhaps complete elimination of the open competitive bid system in federal construction procurement.

The traditional and proven competitive bid procurement system has served federal construction and the taxpaying public well, and must not be cast aside or tampered with under the guise of intending to increase competition when the actual and predictable result would inevitably be decreased competition.

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